

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000)

Docket No. R2000-1

INITIAL BRIEF

OF

VAL-PAK DIRECT MARKETING SYSTEMS, INC.,
VAL-PAK DEALERS' ASSOCIATION, INC., AND
CAROL WRIGHT PROMOTIONS, INC.

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September 13, 2000

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STATEMENT OF THE CASE

COURSE OF PROCEEDINGS

On January 12, 2000, the United States Postal Service filed a request, pursuant to the Postal Reorganization Act (39 U.S.C. sections 3622 and 3623), for a recommended decision by the Postal Rate Commission on certain rates and fees, including proposals relating to Standard A Mail rates, as well as certain changes to the Domestic Mail Classification Schedule.

On January 14, 2000, the Commission issued a Notice of Filing of the Postal Service's submission (Order No. 1279).

In accordance with Order No. 1279 and Rule 20 of the Commission's Rules of Practice and Procedure (39 CFR 3001.20), Val-Pak Direct Marketing Systems, Inc., Val-Pak Dealers' Association, Inc., and Carol Wright Promotions, Inc. (d/b/a Cox Direct), each filed a notice of intervention on January 19, 2000. These three

intervenors have proceeded jointly in this proceeding, and are referred to collectively as either “Val-Pak/Carol Wright” or “VP/CW.”

The Postal Service’s Request

The Postal Service’s Request for a Recommended Decision initiating this proceeding requested rate and fee changes affecting all classes of mail, and asserted that *without those changes the Postal Service would incur a revenue deficiency of \$3.7 billion in the requested test year (FY 2001).* According to the Postal Service’s initial filing, the requested rates, including a contingency of \$1.7 billion (2.5 percent), would generate a revenue deficit of approximately \$21.8 million in the test year.

The Postal Service’s case-in-chief requested changes in Standard A ECR rate design, including a reduction in the pound rate. The Postal Service proposed retaining a zero percent pass-through of the letter-flat differential for Basic mail, while the letter-flat differential for High-Density and Saturation mail would be continued — with a 65 percent *passthrough of the letter-flat differential for the High-Density tier* and a 95 percent *passthrough* for the Saturation tier. The Postal Service also proposed an increase in the residual shape (nonletter, nonflat) surcharge to 15 cents, which has little impact on ECR flat mail due to the very few nonletter, nonflat pieces within ECR.

Discovery of the Postal Service's Case-in-Chief

Counsel for Val-Pak/Carol Wright conducted written cross-examination of seven Postal Service witnesses with respect to their identified direct testimony.

Witness Herbert B. Hunter III	USPS-T-5
Witness Linda A. Kingsley	USPS-T-10
Witness Charles L. Crum	USPS-T-27
Witness Sharon Daniel	USPS-T-28
Witness Virginia J. Mayes	USPS-T-32
Witness Maura Robinson	USPS-T-34
Witness Joseph D. Moeller	USPS-T-35

Counsel for Val-Pak/Carol Wright conducted oral cross-examination of the following Postal Service witnesses, which appears in the record at the identified pages:

Witness Hunter	Tr. 2/952-69
Witness Kingsley	Tr. 5/2042-48
Witness Moeller	Tr. 10/4123-35
Witness Mayes	Tr. 11/4626-35

Val-Pak/Carol Wright Direct Testimony

Val-Pak/Carol Wright sponsored the direct testimony of witness John Haldi (VP/CW-T-1) on Standard A Enhanced Carrier Route Mail (Tr. 32/15751-856), filed on May 22, 2000. During discovery, a total of 56 interrogatories and requests for production of documents were propounded to witness Haldi by the following parties:

Advo, Inc. (ADVO/VP-CW-T1-1-9), Mail Order Association of America (MOAA/VP-CW-T1-1-5), Newspaper Association of America (NAA/VP-CW-T1-1-13), and the Postal Service (USPS/VP-CW-T1-1-23 and 24-29). The responses of witness Haldi to 54 of these interrogatories were designated as written cross-examination in the transcript (Tr. 32/15859-952).

On July 20, 2000, during the hearings, oral cross-examination was conducted of witness Haldi on his direct testimony (Tr. 32/19953-87).

Direct Testimony of Other Intervenors

The Alliance of Independent Store Owners and Professionals sponsored the direct testimony of witness Richard Smith (AISOP-T-1) in support of the Postal Service's proposed reduction to the Standard A ECR (saturation) pound rate (Tr. 30/14528-36). No oral cross-examination of witness Smith was conducted.

The Alliance of Independent Store Owners and Professionals also sponsored the direct testimony of witness Orlando Baro (AISOP-T-2) requesting affordable Standard A ECR (saturation) rates (Tr. 30/14371-82). No oral cross-examination of witness Baro was conducted.

The American Bankers Association and National Association of Presort Mailers sponsored the direct testimony of witness James A. Clifton (ABA&NAPM-T-1) concerning the development of proposed rates for First-Class Mail (Tr. 26/12393-557). This testimony also proposed an additional 0.645 cent increase in rates/decrease in discounts for each rate category of Standard A Regular and ECR, above the amount

requested by the Postal Service. Oral cross-examination of witness Clifton appears at Tr. 26/12642-760.

The Association of Alternative Postal Systems sponsored the direct testimony of witness John White (AAPS-T-1), in which he opposed the Postal Service's proposal to lower the ECR pound rate (Tr. 22/9935-62). Oral cross-examination of witness White appears at Tr. 22/10026-92.

The Association for Postal Commerce and Mail Advertising Service Association sponsored the direct testimony of witness Sander A. Glick (Postcom, et al.-T-1), who proposed Standard A ECR and Regular rates which reflected 100 percent passthroughs of destination entry discounts, as well as greater automation discounts (Tr. 32/15712-35). No oral cross-examination of witness Glick was conducted.

The Association for Postal Commerce and Mail Advertising Service Association also sponsored the direct testimony of witness Joseph E. Schick (Postcom, et al.-T-2), who argued for full passthroughs of destination entry discounts, as well as palletization discounts (Tr. 32/15701-09). No oral cross-examination of witness Schick was conducted.

The Association for Postal Commerce and Mail Advertising Service Association sponsored the direct testimony of witness Joe Lubenow (Postcom et al.-T-3), who discussed the impact of the Postal Service's proposed rates, which reduce the discounts for automated and carrier route mail on the volumes of mail with poor address quality (Tr. 29/14082-107). No oral cross-examination of witness Lubenow was conducted.

The Newspaper Association of America sponsored the direct testimony of witness William E. Tye (NAA-T-1) concerning Standard A Mail rates (Tr. 30/14687-771). Witness Tye opposed the Postal Service's reduction to the Standard A ECR pound rate, and called for an increase in ECR cost coverage, and for all undiscounted ECR rates to receive increases. Oral cross-examination of witness Tye appears at Tr. 30/14874-5004.

The Saturation Mail Coalition sponsored the direct testimony of witness Harry J. Buckel (SMC-T-1), who discussed the loss of market share by shared mail, and stated that the Postal Service's proposed reduction in the Standard A ECR pound rate would help such mailers retain customers (Tr. 22/9903-17). No oral cross-examination of witness Buckel was conducted.

The Saturation Mail Coalition also sponsored the direct testimony of witness Roger Merriman (SMC-T-2), who stated that the Postal Service's proposed reduction in the Standard A ECR pound rate would help mail delivery become competitive with alternative delivery (Tr. 32/15656-71). Oral cross-examination of witness Merriman appears at Tr. 32/15698.

The Alliance of Nonprofit Mailers, American Business Media, Coalition of Religious Press Associations, Dow Jones & Company, Inc., Magazine Publishers of America, Inc., The McGraw-Hill Companies, Inc., National Newspaper Association, and Time Warner Inc., sponsored the direct testimony of witness Halstein Stralberg (TW-T-1), which addressed Periodicals cost and rate design, and the distribution of clerk and mailhandling cost (Tr. 24/11344-416). In his testimony, witness Stralberg

also proposed that Standard A DDU rates include the costs avoided by the requirement that mailers unload their DDU-dropshipped mail. Oral cross-examination of witness Stralberg appears at Tr. 24/11476-85.

Val-Pak/Carol Wright Discovery of Other Intervenors

Val-Pak/Carol Wright submitted a total of 19 interrogatories and requests for production of documents to other intervenor witnesses. All 19 of the responses to the Val-Pak/Carol Wright interrogatories were designated as written cross-examination of these witnesses. These responses appear in the record as follows:

Clifton (VP-CW/ABA&NAPM-T1-1-7, Tr. 26/12626-41)

Tye (VP-CW/NAA-T1-1-12, Tr. 30/14854-69)

Counsel for Val-Pak/Carol Wright orally cross-examined the following two intervenor witnesses on their direct testimony: Clifton (ABA&NAPM-T-1) (Tr. 26/12699-722) and Tye (NAA-T-1) (Tr. 30/14951-82, 14996-97).

Rebuttal Testimony

Val-Pak/Carol Wright sponsored the rebuttal testimony of witness Haldi (VP/CW-RT-1, Tr. 44/18843-72). Witness Haldi's rebuttal testimony critiqued: (i) witness Tye's (NAA-T-1) proposed increase to Standard A ECR's costs and markup (Tr. 30/14687-741); and (ii) witness Clifton's (ABA/NAPM-T-1) proposal to change the cost coverages for First-Class Mail and Standard A Mail (Tr. 26/12393-557).

In addition to rebuttal by witness Haldi, witness Tye's testimony (NAA-T-1) was rebutted by witness Antoinette Crowder (ADVO-RT-1, Tr. 44/19363-408), witness Roger C. Prescott (MOAA, et al.-RT-1, Tr. 44/19265-327), witness Vincent Giuliano (SMC-RT-2, Tr. 44/18985-9005), witness Bernard Bradpiece (SMC-RT-1, Tr. 44/18908-22), witness A. Thomas Bozzo (USPS-RT-18, Tr. 44/19460-82) and witness Donald J. O'Hara (USPS-RT-19, Tr. 46/21932-63).

In addition to rebuttal by witness Haldi, Witness Clifton's testimony (ABA/NAPM-T-1) was rebutted by witness Prescott (MOAA, et al.-RT-1, Tr. 44/19313-20), witness Miller (USPS-RT-15, Tr. 45/19641-92), and witness Bozzo (USPS-RT-18, Tr. 44/19470-04).

The Mail Order Association of America and Direct Marketing Association sponsored witness Prescott's rebuttal testimony (MOAA, et al.-RT-1), which attempted to rebut witness Haldi's direct testimony (Tr. 44/19265-327). This rebuttal testimony is analyzed at Section II, *infra*. Counsel for Val-Pak/Carol Wright cross-examined witness Prescott on August 29 on his rebuttal testimony (Tr. 44/19347-57).

Advo, Inc., sponsored witness Crowder's rebuttal testimony (ADVO-RT-1, Tr. 44/19363-408), which attempted to rebut witness Haldi's direct testimony. This rebuttal testimony is analyzed at Section II, *infra*. Counsel for Val-Pak/Carol Wright cross-examined witness Crowder on August 29 on her rebuttal testimony (Tr. 44/19435-52).

The Postal Service sponsored witness Bozzo's rebuttal testimony (USPS-RT-18, Tr. 44/19460-82), which attempted to rebut witness Haldi's analysis regarding both the

shortcomings of reliance on IOCS data to distribute costs by weight increment, and the untrustworthiness of witness Daniel's study based upon such data to determine an appropriate pound rate. This rebuttal testimony is analyzed at Section II, *infra*.

Counsel for Val-Pak/Carol Wright cross-examined witness Bozzo on August 29 on his rebuttal testimony (Tr. 44/19501-15).

SUMMARY OF ARGUMENT

The Postal Service's request with respect to Standard A ECR rate design does not include Standard A ECR rates that are as cost-based as they could and should be. Val-Pak/Carol Wright, through the testimony of witness John Haldi, have developed alternative rates for Standard A ECR Mail that provide the same revenues and contribution to institutional cost for the entire subclass as the rates proposed by the Postal Service. However, in light of the excessively high coverage (and unit contribution) imposed on Standard A ECR Mail, Val-Pak/Carol Wright propose a second, more economically-efficient set of rates which would reduce the average unit contribution of this more heavily workshared subclass of Standard A commercial mail and bring it closer to the average unit contribution of the less heavily workshared Standard A Regular.

Both sets of rates proposed by Val-Pak/Carol Wright reflect a pound rate for Standard A ECR higher than proposed by the Postal Service, as well as retention of the current 85 percent passthrough for destination entry discounts. Record evidence is not adequate to support any change in the pound rate. Both sets of proposed rates also correct for inconsistency between the IOCS system (used to estimate costs by shape) and the RPW system (used to estimate volume by shape) in the identification of flats and letters — for “overweight” letters.

As discussed above, witness Haldi developed rates reflecting a reduced cost coverage for Standard A ECR (from the 209 percent recommended by the Postal Service to 202 percent). This change in coverage reduces the revenue target for ECR

by \$177 million, or 3.4 percent, from the Postal Service's proposal. Witness Haldi observes that there is plenty of room for reducing the revenue target, as the requested contingency allowance of 2.5 percent is far too high — representing an astonishing 46 percent of the proposed increase to the revenue requirement in this docket.

Witness Haldi further demonstrates that the difference in unit contribution between Standard A Regular and Standard A ECR has gone from roughly comparable (in FY 1997) to where ECR's unit contribution will be half again as large as Regular for TYAR. (ECR's unit contribution has been estimated to be more than twice as large as that of Regular for FY 2000 and TYBR). Witness Haldi observes that the overall trend of widening differences in unit contributions is wholly ignored by the Postal Service in its case-in-chief, and explains that, under the efficient component pricing principle for monopoly bottleneck pricing, comparable products (such as Standard A ECR and Regular) should have unit contributions that are roughly equal — particularly in light of the far greater elasticity of ECR (more than 1.4 times greater than Regular). Therefore, the widely divergent unit contributions of these subclasses border on an anomaly in the rate structure.

The criticisms of witness Haldi's proposals by witnesses Bozzo, Crowder, and Prescott are erroneous.

Other intervenor testimony, suggesting changes to Postal Service's Standard A rate request, propose changes that would be counterproductive and should not be recommended.

ARGUMENT**I. THE POSTAL SERVICE'S REQUEST FOR STANDARD A ECR RATES SHOULD BE MODIFIED.**

Witness Moeller (USPS-T-35), the Postal Service's Standard A rate design witness in this docket, discusses Standard A ECR at pages 18 through 28 of his testimony. Witness Moeller employs the traditional top-down rate design methodology in designing requested rates for Standard A ECR Mail.

Among the changes in Standard A ECR rate design requested by the Postal Service are:

- a reduction in the destination entry discount passthrough (from 85 percent to between 73 and 77.5 percent);
- increases in the density tier passthroughs (to 125 percent between Basic and High Density letters, to 63 percent between Basic and High-Density nonletters, and to 84 percent between High Density and Saturation nonletters);
- a reduction in the pound rate (from 66.3 cents to 58.4 cents, for mailpieces receiving no destination entry discount); and
- increases in the piece rates for pound-rated mail (2.5 cents for Saturation, 2.0 cents for High-Density, and 3.0 cents for Basic).

The Postal Service's proposed reduction to the ECR pound rate, and corresponding increases to the piece rate for pound-rated mail, should not be recommended. Also, more cost-based destination entry discount, presort discount, and letter/flat differential passthroughs should be employed. VP/CW has demonstrated, through the testimony of witness Haldi, that the Postal Service has overstated letter costs and understated flat costs in its underlying calculations.

A. Witness Moeller's Destination Entry Passthroughs Would Result in Less Cost-Based Rates.

Witness Moeller's proposes passthroughs of destination entry discounts, which vary between 73 and 77.5 percent, and represent yet another step backward from the 100 percent passthroughs adopted by the Commission in Docket No. MC95-1. USPS-T-35, p. 27, ll. 1-2; *see also* USPS-T-36, p. 30, Docket No. R97-1, *Op. & Rec. Dec.*, Docket No. MC95-1, para. 5645. Under the Postal Service's proposal, destination entry discounts would receive only a minimal increase, by a nominal amount: the piece-rated DBMC discount would increase from 1.6 cents per piece to 1.7 cents per piece; the DSCF discount would increase from 2.1 cents per piece to 2.2 cents per piece; and the DDU discount would increase from 2.6 cents per piece to 2.8 cents per piece. The pound-rated DBMC discount would increase from 7.9 cents per pound to 8.3 cents per pound; the DSCF discount would increase from 10.0 cents per pound to 10.8 cents per pound; and the DDU discount would increase from 12.6 cents per pound to 13.4 cents per pound. On an inflation-adjusted basis, the proposed discounts actually represent a reduction in real economic terms. Such passthroughs are clearly inadequate.

Witness Haldi proposes, at minimum, retention of the 85 percent destination entry passthroughs recommended by the Commission in Docket No. R97-1. VP/CW-T-1, pp. 19-25, Tr. 32/15773-79. Witness Moeller offers no justification for his departure from the Commission's precedent that might support his reductions to the destination entry discount passthrough. *Id.*, p. 21, ll. 12-18, Tr. 32/15775.

Furthermore, he fails to capture **weight-related** costs avoided by presortation in his

identification of presortation costs avoided. Witness Haldi suggests that maintaining destination entry discount passthroughs at the current levels would mitigate the failure to include these avoided costs. *Id.*, pp. 21-22, Tr. 32/15775-76.

The evidence in this docket demonstrates that mailers of Standard A products respond to these discounts — in FY 1998, 62 percent of all Standard A mailpieces received destination entry discounts (71 percent by weight). *Id.*, p. 22, ll. 12-13, Tr. 32/15766-67. In addition, a higher passthrough is more consistent with efficient component pricing, while “artificially holding down the level of worksharing discounts sends the wrong signals to high-cost mailers, does nothing to promote social efficiency, and helps perpetuate the Postal Service in its inefficient ways.” *Id.*, pp. 23-24, Tr. 32/15777-78. Maintaining or raising the passthrough would benefit every category of Standard A ECR, and should be recommended. *Id.*, pp. 24-25, Tr. 32/15778-79

B. The Letter/Flat Cost Differential and Density Tier Passthroughs Should Be Increased.

Consistent with the Postal Service’s proposed rates in Docket No. R97-1, witness Moeller’s rate design recognizes no letter/flat differential at the ECR Basic level (a 3.0 cent difference). USPS-T-28, p. 29, Table 7. Since nonletter costs are so much higher than letter costs, witness Moeller must pass through 125 percent of the Basic/High-Density letter cost avoidance, and only 63 percent of the corresponding nonletter cost avoidance, to prevent flat rates from falling below letter rates at the High-Density level. USPS-T-35, p. 25. Since Moeller proposes only a 65 percent

passthrough of the Postal Service's calculated letter/flat differential for High Density, this would result in High-Density letter rates (at each degree of dropshipment) which are only 0.2 cents less than the corresponding flat rates. *Id.*, pp. 25, 28.

In an effort to recapture some of the true ECR letter/nonletter cost distinctions which are obliterated by the ECR basic rate convention, witness Haldi proposes a 95 percent letter/nonletter passthrough for High-Density, and an 140 percent Basic/High-Density letter presort passthrough. At his proposed rates, the High-Density letter rates would be 0.7 cents less than the corresponding flat rates. Thus, witness Haldi's proposed passthroughs would offset the absence of a letter/nonletter passthrough at the Basic ECR rate, and would more evenly spread the burden of the rate increase proposed by witness Mayes. VP/CW-T-1, p. 25, ll. 3-15, Tr. 32/15779.

C. The Conflicting Definitions of a Letter by the IOCS and the RPW Result in the Overstatement of ECR Letter Costs.

The Postal Service has overstated ECR letter costs, and understated ECR flat costs. This miscalculation arises from an inconsistency between the definition of letter and nonletter under the Revenue/Pieces/Weight ("RPW") system, and that utilized by the In-Office Cost System ("IOCS"). The RPW system records letter-shaped pieces¹ which weigh more than the breakpoint as nonletters, while the IOCS identifies such pieces as letters. Thus, for every letter-shaped mailpiece over the breakpoint ("heavy letter"), the IOCS will record the costs incurred as attributable to ECR letters, but

¹ As defined by the Domestic Mail Manual.

RPW will not correspondingly increase the identified volume of ECR letters. By contrast, RPW will record an additional nonletter, which would be unaccompanied by any corresponding increase to nonletter costs. VP/CW-T-1, pp. 11-14, Tr. 32/15765-68.

To correct for such overstatement of ECR letter costs, witness Haldi estimates that 2.6 percent of letter-shaped ECR mailpieces are subject to this inconsistency. Based upon his calculations, witness Haldi proposes that the letter-flat differential be increased by 0.29 cents. *Id.*, pp. 16, A-1 through A-8, Tr. 32/15770, 15812-19.²

1. Witness Prescott's Criticisms of Witness Haldi's Letter/Flat Differential Analysis Lack Merit.

Witness Prescott criticizes witness Haldi's analysis of the mismatch of costs and volumes between ECR letters and flats for its reliance on Library Reference USPS-LR-I-92, noting that the Postal Service's calculation of the ECR letter-flat cost differential is based upon data found in USPS-LR-I-95 and USPS-LR-I-96. He states that the Postal Service's calculation reflects only mail processing and delivery costs, while USPS-LR-I-92 includes additional costs. MOAA, et al.-RT-1, pp. 37-38, Tr. 44/19305-06.

² Analysis of an additional letter-flat inconsistency, regarding the treatment of letter-shaped ECR detached address label mailpieces, was withdrawn by witness Haldi. Tr. 32/15746-48.

Witness Prescott's rebuttal testimony provides an example supposedly designed to illustrate a "conceptual error" by witness Haldi.³ He states that:⁴

[w]itness Haldi's proposed methodology for adjusting the USPS classification problem is to move the shape-based costs that are mismatched and leave the piece count in its misclassified position. [Emphasis in original.]

The preceding statement by witness Prescott displays a basic misconception, hence it is witness Prescott who makes a fundamental error, not witness Haldi. What witness Prescott fails to realize is that from a rate-making perspective, the concept of a "heavy letter" is an oxymoron. Any piece that weighs more than the breakpoint is, by definition, a non-letter,⁵ and it pays the pound rate, **regardless of shape**. The RPW appropriately includes such pieces as non-letters, hence they are **not** misclassified, as witness Prescott states. Witness Prescott's testimony on this issue should be disregarded.

2. **Witness Crowder Agrees That Heavy Letter Costs are Misattributed — She Disagrees About the Size of the Remedy.**

Witness Crowder (ADVO-RT-1) asserts that witness Haldi's heavyweight letter analysis — which demonstrates the shifting of costs from ECR flats to letters due to inconsistency between the RPW and IOCS systems — both overstates the effect of this

³ MOAA, et al.-RT-1, p. 41, Table 8.

⁴ MOAA, et al.-RT-1, p. 42.

⁵ For ratemaking purposes, all non-letters are classified as either a flat or a "parcel." A "heavy-weight" letter is obviously not a parcel, hence its cost should be included in the cost of flats.

inconsistency, and incorrectly assumes that the costs improperly attributed to ECR letters are piece-related, rather than weight-related. Her arguments do not withstand scrutiny.

Witness Crowder asserts that adoption of a letter-flat cost differential passthrough at or near 100 percent would result in double-recovery of the cost differences, because some of the letter-flat cost differential reflects weight-related costs. ADVO-RT-1, p. 39, Tr. 44/19404. She does not identify or quantify such costs, however. She simply concludes that the Commission should reject witness Haldi's proposed increase to the letter-flat rate differential, and recommend the Postal Service's proposed rates. *Id.*, p. 43, Tr. 44/19408.

Witness Crowder acknowledges the existence of an inconsistency in the treatment of ECR letter and flat volumes and costs – *i.e.*, she acknowledges the existence of a mismatch. At the same time, however, she does not understand the essence of the mismatch problem. For example, she states “[e]ffectively, Dr. Haldi’s analysis requires **both volume and** cost corrections.... [After my cost adjustment] Then **both volume and** cost of heavy-weight letters were shifted to flats.” (Emphasis added.) ADVO-RT-1, p. 40, Tr. 44/19405. The very essence of a mismatch is that volumes are included in one place, while costs are included in another; *i.e.*, one is correct, while the other is incorrect. To set things right, one must (i) determine which is incorrect, and (ii) then make the appropriate shift to adjust for that which is incorrect. Specifically, in this instance the RPW data **correctly** count heavy-weight letter-shaped pieces as non-letters (or flats), because they pay the non-letter rate.

Consequently, not only is there no need to shift volume and make an adjustment to RPW volume data, as witness Crowder does, it is also wrong to do so. Her “results,” derived in her Table V-1, are therefore in error and should be disregarded.⁶

⁶ The extent of the error arising from the mismatch cannot be known precisely. For development of an upper and lower bound on the appropriate cost adjustment, *see* response to USPS/VP-CW-T1-29, Tr. 32/15947-52.

II. THE PROPOSED ECR POUND RATE LACKS EVIDENTIARY SUPPORT AND SHOULD NOT BE ADOPTED.

The evidentiary support provided by the Postal Service fails to justify its proposed reduction in the pound rate for Standard A Mail, especially ECR mail. VP/CW-T-1, pp. 18-19, B-1 through B-28, Tr. 32/15772-73, 15823-50. For example, weight-cost studies based on IOCS data are inherently suspect, in large part because (as witness Daniel acknowledges) IOCS data were “not specifically designed for the purpose of measuring the impact of weight on costs.” *Id.*, B-2, ll. 2-5, Tr. 32/15824, *see also* pp. B-21 through B-23, Tr. 32/15843-45. Witness Haldi criticizes witness Daniel’s use of direct tallies where weight of the mailpiece is recorded (a minority of all tallies) as a basis to distribute costs associated with tallies where no weight is recorded. Tr. 32/15843-44. He explains how weight is likely to be a much more important cost driver in a variety of activities where no weight is recorded on the tallies.

Witness Daniel’s methodology fails to (i) recognize the likely existence of different weight-cost relationships, not only as between subclasses, but also within subclasses, (ii) identify the weight-cost relationship(s) which her analysis was designed to determine, and (iii) measure the impact of weight on mail processing costs, especially for differing levels of presort (a failure due in part to the inherent inability of IOCS to record the weight, presort condition and entry point of mailpieces tallied). *Id.*, pp. B-5 through B-17, Tr. 32/15827-39. The data generated by witness Daniel’s weight-cost analysis are unstable and unreliable *Id.*, pp. B-23 through B-25, Tr.

32/15845-47. Witness Haldi suggests that the destination entry model could supply the foundation for a more credible weight-cost study conducted in the future. *Id.*, pp. B-3 through B-4, Tr. 32/15825-26.

A. Witness Daniel's Regression Analyses Present an Ambiguous, Limited and Confusing Characterization of Weight-Cost Relationships Within the Subclasses of Standard A Mail.

The testimony of witness Daniel (USPS-T-28) and her supporting library reference for Standard A Mail (USPS-LR-I-92) provide (i) data on estimated costs of Standard A Mail by weight increment, developed from IOCS tallies, and (ii) extensive regression analyses, based on the cost data by weight increment, purportedly undertaken to shed light on the extent to which additional weight causes costs to increase.⁷ All of her regressions indicate that costs increase with weight for each subclass within Standard A Mail, as one would anticipate. Beyond that somewhat vague generality, however, witness Daniel's regression results present a smorgasbord of inconclusive data which are easily malleable to craft support for a wide range of possible rate designs, including pound rates which are higher than current rates. At best, witness Daniel's regression results are highly confusing, ambiguous and over-inclusive; at worst, they lack content. Thus, her regressions have no appropriate place

⁷ USPS-LR-I-92 presents raw data and regression results without any analysis, editorial comment or discussion as to either the merits or shortcomings associated with any of the different regression models presented therein.

in the ratemaking process.⁸ Significantly, witness Daniel implicitly acknowledges the weaknesses of her work by declining to recommend any particular result to witness Moeller (or to the Commission) as indicating the most appropriate weight-cost relationship to be used for purposes of rate design within Standard A Mail. Witness Moeller evidently recognizes this deficiency, as he declines to adopt or rely on any particular result from witness Daniel's regression analyses.

The wide variety of costing results presented by witness Daniel's regressions for Standard A Regular and ECR are illustrated, respectively, in Tables 1 and 2 *below*. Each result is based on one of witness Daniel's regressions. These regressions were each derived from mail in all presort conditions and entered at all destination entry points reflected in the rate schedule.

Witness Daniel's regressions have different slopes and intercepts. Computing the indicated cost for a 16-ounce piece provides a convenient, common basis for comparison, and allows direct comparison to the current and proposed pound rates. The computed cost for a 16-ounce piece (based on the underlying regression) is shown in Table 1, column 1.⁹ The computed cost is marked up using the 132.9 percent

⁸ Postal Service rebuttal witness Bozzo, although attempting to support the thrust of witness Daniel's analysis, characterizes all of her regression computations in USPS-LR-I-92 as "superfluous." *See* section D, *infra*, for further discussion of witness Bozzo's testimony on the subject.

⁹ Tables 1 and 2 omit results for regression models that are limited to letters only.

coverage level recommended by witness Mayes (USPS-T-32) for Standard A Regular.¹⁰ The indicated rate is shown in column 2.¹¹ Amazingly, for a 16-ounce piece, witness Daniel's regressions support rates ranging from \$0.45 to \$1.51 per pound. This absurdly wide range of indicated rates completely spans both the current rates and proposed rates. For Standard A Regular, the maximum rates (*i.e.*, with no discounts) and the minimum rates (*i.e.*, with largest possible discounts) are shown for convenience at the bottom of Table 1.

¹⁰ When witness Moeller and other intervenor witnesses say costs do not justify the high pound rate, they fail to point out that the cost of weight is always marked up in all subclasses: *i.e.*, for First-Class Mail, Priority Mail, Periodicals, and Standard B the incremental rate for additional weight is never alleged to be set equal to the underlying cost.

¹¹ Each indicated rate could be achieved through any number of combinations of per-piece and per-pound rates.

Table 1

Indicated Cost and Rate for a 16-Ounce Piece of
Standard A Regular Mail, Based on Witness Daniel's Regressions

	(1)	(2)	(3)
	Indicated Cost of a 16-oz piece	Indicated Rate for a 16-oz Piece Using Coverage of 1.329	Source: USPS-LR-I-92, Section 1 ¹
<u>Detailed Half-ounce Increments:</u>			
1. All shapes	\$0.8008	\$1.0643	p. 10
2. All shapes, pound-rated	1.1378	1.5121	p. 11
3. Flats	0.3652	0.4734	p. 16
<u>Combined Weight Increments:</u>			
4. All shapes	0.7180	0.9542	p. 12
5. All shapes, pound-rated	0.8978	1.1932	p. 12
6. All Flats	0.3409	0.4531	p. 18
7. Flats greater than 3 ounces	0.4398	0.5845	p. 18
<u>Current Rates for 16-oz piece:</u>			
No Destination Entry			
Basic		0.841	
3/5 Digit		0.777	
SCF Entry			
Basic		0.741	
3/5 Digit		0.677	
<u>Proposed Rates for 16-oz piece:</u>			
No Destination Entry:			
Basic		0.836	
3/5 Digit		0.783	
SCF Entry			
Basic		0.728	
3/5 Digit		0.675	

¹ See Table A-1 in Appendix.

Table 2 is similar to Table 1, but reflects data for Standard A ECR. The indicated rate for a 16-ounce piece is computed using the 208.8 percent coverage recommended by witness Mayes for Standard A ECR. Almost as amazingly, for ECR, witness Daniel's regressions support rates for a 16-ounce piece which — for a subclass with significantly smaller unit costs — range from \$0.52 to \$0.93. This also is an astonishingly wide range. Even so, this range does not include the very low pound rates proposed by witness Moeller for DDU-entered pieces.

Table 2

Indicated Cost and Rate for a 16-Ounce Piece of
Standard A ECR Mail, Based on Witness Daniel's Regressions

	(1)	(2)	(3)
	Indicated Cost of a 16-oz piece	Indicated Rate for a 16-oz Piece Using Coverage of 2.088	Source: USPS-LR-I-92, Section 2 ¹
<u>Detailed Half-ounce Increments:</u>			
1. All shapes	\$0.3198	\$0.6677	p. 10
2. All shapes, pound-rated	0.4447	0.9285	p. 11
3. Flats	0.2745	0.5732	p. 17
<u>Combined Weight Increments:</u>			
4. All shapes	0.2833	0.5915	p. 12
5. All shapes, pound-rated ²	0.3736	0.7801	p. 12
6. All shapes, pound-rated ²	0.2864	0.5980	p. 13
7. All Flats, all weights	0.2517	0.5255	p. 19
8. All Flats pound-rated	0.2961	0.6183	p. 19
<u>Current Rates for 16-oz piece:</u>			
No Destination Entry:			
Basic		0.688	
Saturation		0.666	
DDU Entry			
Basic		0.562	
Saturation		0.540	
<u>Proposed Rates for 16-oz piece:</u>			
No Destination Entry:			
Basic		0.639	
Saturation		0.618	
DDU Entry			
Basic		0.505	
Saturation		0.484	

¹ See Table A-2 in Appendix.

² Rows 5 and 6 reflect different aggregations by ounce.

B. Witness Crowder Compounds the Confusion.

A substantial portion of the rebuttal testimony of witness Crowder (ADVO-RT-1) is concerned with the weight-cost relationship. Tr. 44/19370-400. Her testimony focuses exclusively on Standard A ECR Mail. She fully comprehends the ambiguities and inherent weaknesses in witness Daniel's analyses of the weight-cost relationship. Nevertheless, witness Crowder undertakes to rescue the Postal Service's proposal for a low ECR pound rate by performing her own analyses of the available data.

Witness Crowder not only employs data from witness Daniel's library reference, USPS-LR-I-92, but also draws on supplementary data provided in response to ADVO/USPS-T28-13 and in witness Crum's testimony (USPS-T-27). Tr. 44/19375. For reasons explained below, witness Crowder's testimony fails to clarify the proper weight-cost relationship for Standard A ECR. Instead, she adds to the confusion, further illustrating why the record evidence is wholly inadequate and why the Commission would need a more credible study of the weight-cost relationship for Standard A ECR Mail (as well as for other subclasses), as recommended by witness Haldi (VP/CW-T-1, pp. 18-19, Tr. 32/15772-73.), before modifying the pound rate.

1. Witness Crowder's Results Support Different Weight-Cost Relationships for Different Presort Levels.

Witness Crowder derives a variety of weight-cost relationships. Interestingly, in each instance, she shows a separate estimated cost for (i) Basic, and (ii) High-

Density/Saturation Standard A ECR.¹² In each case, the weight-cost relationships differ significantly, **depending on presort level**.¹³ The cost differences between Basic and High-Density/Saturation derived by witness Crowder thus lend support to the testimony of witness Haldi, who explains why each subclass of Standard A Mail probably has more than one weight-cost relationship, depending on presort level and point of entry. Tr. 32/15824.

Witness Crowder's purpose is to try to justify a lower pound rate for Standard A ECR Mail. She does not attempt to explain the different cost relationships or argue the superiority of any particular result which she presents, nor does she endorse any of witness Daniel's regression models. She even appears not to have enough confidence in her analysis to offer the Commission a specific weight-cost relationship that she would argue is sufficiently credible to be used for rate-making.

Broadly, the Commission appears to have four choices with respect to the ECR pound rate: (i) maintain the pound rate at its current level; (ii) maintain the pound rate at its current level but increase the passthrough for destination entry discounts, as recommended by witness Haldi; (iii) incorporate a pound element into presortation discounts, at least for pound-rated mail; or (iv) make some uniform change in the pound rate for all ECR mail. Realistically, though, the choice is between options

¹² See Table III-1 (Tr. 44/19377); Figures III-1 and III-2 (Tr. 44/19378); and Table III-3 of witness Crowder (Tr. 44/19382).

¹³ With respect to these differences, witness Crowder does not present any tests of statistical significance.

(i) and (ii), because the record evidence does not provide adequate support for either of the last two alternatives.

2. Witness Crowder's So-called "Worst Case" Estimates Actually Support a Pound Rate for Standard A ECR Mail That is Higher Than the Current Rate.

Witness Crowder states that if all costs of ECR flats were purely weight-related, then the per-pound cost estimates for ECR flats with DDU entry would be as follows:¹⁴

Basic Flats	\$0.388
High-Density/Saturation Flats	0.259
All Flats	0.334

For non-dropshipped mail, she indicates that \$0.173 should be added to the above costs.¹⁵

Using witness Mayes' recommended cost coverage of 208.8 percent for Standard A ECR Mail, witness Crowder's per-pound cost estimates indicate the per-pound rates for dropshipped mail shown below in column (2) and the per-pound rates for non-dropshipped mail in column (3).

¹⁴ Tr. 44/19377.

¹⁵ *Id.* The \$0.173 is witness Crum's estimate of total costs avoided by DDU entry of Standard A Mail.

Table 3A

Indicated Cost and Rate for a 16-Ounce Piece of
Standard A ECR Mail, Based on
Witness Crowder's Allocation of All Costs to Weight

	(1)	(2)	(3)
	Per Pound Cost for DDU Entry	DDU Rate: Column (1) x 2.088 Coverage	Indicated Rate For a 16-oz. Piece = Marked Up Cost at DDU Plus Cost of \$0.173 for Entry at Origin
Basic Flats	\$0.388	\$0.807	\$0.980
[ok?]Hi-D/Sat Flats	0.259	0.539	0.712
All Flats	0.334	0.695	0.868

Witness Crowder obviously does not recommend adoption of the above rates.

With respect to her results, she states:¹⁶

The above results for Case 1 represent a "beyond worst case" estimate under the absurd assumption that *a//* ECR flat costs are purely weight-related (*i.e.*, assuming zero piece-related costs).... However, no one can doubt that all flats incur some strictly piece-related costs (*i.e.*, costs related to the number or shape of pieces).

Witness Crowder obviously feels that some costs are not pound related.

Notwithstanding her caveats, her "worst-case" results may be far more realistic than she would care to admit. Saturation ECR flats arrive at the DDU in bulk, are handled within the DDU in bulk and, when carried on the route as a third bundle (which is said to be typical), they are loaded in bulk directly into the carrier's vehicle. All of these

bulk handlings are obviously pound-related costs. The first and only time such saturation ECR flats receive a piece handling is when they are placed in the recipient's mailbox. About half of all city carrier out-of-office costs are elemental load costs. Thus, if witness Crowder embraces witness Daniel's assumption that all elemental load costs for Standard A Mail should be treated as weight related, then her "worst-case" costs and the indicated rate for a 16-ounce piece of saturation ECR mail would be rather close to an appropriate level.¹⁷ The difference between Saturation and Basic ECR flat costs and the indicated rates for a 16-ounce piece are explained by the additional piece handling which Basic flats receive when they are sorted into route sequence within the DDU.

In a related exercise, described by witness Crowder as "Case 2," she presents per-pound cost estimates for ECR flats with DDU entry on the assumption that "[a]ll cost for pieces over the breakpoint is purely weight-related." Tr. 44/19377. These cost estimates for DDU entry are as follows:

Basic Flats	\$0.268
Hi-D/Sat Flats	0.199
All Flats	0.243

To conduct this exercise, she presumably has deleted (i) the volume of flats under the breakpoint, as well as (ii) the estimated costs of all flats under the breakpoint. In other words, she has omitted lighter-weight, lower-cost flats from the computation.

¹⁷ Rebuttal witness Bozzo (USPS-RT-18) goes to considerable lengths to show that witness Daniel's assumptions with respect to elemental load costs make no meaningful difference in the final result.

Since the exercise in Case 2 is designed to isolate the cost of heavier-weight flats with a (presumably) higher unit cost, one normally would expect the resulting unit costs to be higher than the average for all flats, discussed above under “Case 1.” Nevertheless, she obtains just the opposite result. Her unit costs for flats **above the breakpoint** are 23 to 31 percent **lower** than the unit costs for **all** flats. Since her work papers do not indicate how these results were obtained, it cannot be checked. In any event, not only does witness Crowder’s “Case 2” compound the confusion surrounding the weight-cost relationship of ECR mail, it also stands alone among the weight-cost analyses presented by all witnesses. Aside from this exercise, no witness has yet argued that unit cost decreases as average weight increases. Her “Case 2” should be disregarded.

3. Witness Crowder’s Regression Results Provide Even More Opportunities to Manipulate the IOCS-Based Data, and Widen the Range of Uncertainty Surrounding Witness Daniel’s Results.

As discussed previously, witness Crowder computes separate regressions for Basic ECR flats and High-Density/Saturation flats. Tr. 44/19378. Her regression results, shown in a format similar to that of Tables 1 and 2, are presented here in Table 3. She states that her cost data have been adjusted, with the exception that no adjustment for dropshipment has been made; *i.e.*, the cost data reflect the actual mix of dropship characteristics in the underlying data. Tr. 44/19378 (fn. 10). The computed costs and indicated rates for a 16-ounce piece are seen to be far below any of witness Daniel’s results for ECR mail are shown in Table 2, *supra*. These results thus broaden the varied smorgasbord of regression results that can be computed using IOCS-based data, and add to the confusion accompanying the interpretation and application of such

data. Witness Crowder does not compare the results from her two regression models with any of the regression models offered by witness Daniel.

Table 3B

Indicated Cost and Rate for a 16-Ounce Piece of
Standard A ECR Mail, Based on
Witness Crowder's Regressions

	(1)	(2)	(3)
	Indicated Cost of a 16-oz piece	Indicated Rate for a 16-oz Piece Using Coverage of 2.088	Source: ADVO-RT-1 (Tr. 44/19738)
Detailed Half-ounce Increments:			
1. Basic flats	\$0.2748	\$0.5737	p. 13, Fig III-1
2. Hi-Density/ Saturation flats	0.1888	0.3941	p. 13, Fig III-2

4. Witness Crowder's Assertions of Large Scale Economies in Bulk Handling Operations Lack Any Evidentiary Support.

All of witness Crowder's quantitative results are based on cost data derived from IOCS tallies. Although weight is presumably a cost driver, she recognizes that IOCS tallies provide no explanation whatsoever of where, why or how an increase in weight drives costs. She therefore attempts to hypothesize some reasons to support her results, based on the concept of economies of scale. She states that "[w]hen mail is handled in bulk (*i.e.*, in bundles, containers, transportation vehicles, and carrier

satchels), the related costs are a function of total weight.” Tr. 44/19390. She then goes on to state that “[witness Haldi] glosses over the fact that bulk handling costs are characterized by large scale economies.” Her argument consists of the following assertions:

1. For any particular type of bulk container (*e.g.*, tubs, trays, pallets, hampers) the cost of handling that container tends to be the same, regardless of whether the container is full or partially empty. (ADVO-RT-1, p. 25, Tr. 44/19390.)
2. The average bulk mail container has excess capacity. *Id.*
3. Larger containers may be more efficient to handle, on a per pound basis, than smaller containers, and an increase in the weight of a mailpiece may “actually cause the mailing to be placed in larger capacity, more efficient containers.” (ADVO-RT-1, p. 26, Tr. 44/19391.)

Her first point, which appears intuitively reasonable, depends critically on the second point, excess capacity in bulk containers. That, in turn, is an assertion of fact which is unsupported by any evidence whatsoever. The Postal Service has literally millions of containers, such as tubs and hampers, and hundreds of thousands of owned and leased trucks. When one observes replication *en masse* of such smaller items, rather than the use of containers of increasing size, economies of scale are normally non-existent.¹⁸ Assertions that bulk containers, such as tubs and hampers, are subject

¹⁸ Pipelines exhibit economies of scale because the cost of the pipe depends on the circumference, while throughput depends on the cross-sectional area. As size of the pipe increases, the area (πr^2) increases faster than the circumference ($2\pi r$), *i.e.*, throughput increases faster than cost.

to significant economies of scale in operations the size of Postal Service plants and distribution centers boggle the mind.

Witness Crowder admits that when truckloads of mail arrive at the loading dock, mailers likely have filled the truck to capacity, and unloading two truckloads of mail would approximately double the cost of unloading one truckload; *i.e.*, the more mail there is to unload, the more it costs, and no economies of scale exist with respect to unloading trucks. Tr. 44/19477-78.

With respect to internal handling within a postal facility, witness Crowder makes an implicit assumption that an increase in weight of mail pieces virtually **always will fill** some excess capacity, **but never create** any excess capacity. For bulk containers such as tubs or trays, this assertion clearly is unsupportable. A simple example clarifies the point.¹⁹ Consider a flat sorting machine with 100 separations and assume that (i) the capacity of a flats tub is 30 pounds of mail, and (ii) during the sorting process, flats are distributed evenly to each bin. Then, under these conditions, if the mail being sorted weighs less than 3,000 pounds (*e.g.*, 24,000 pieces weighing 2 ounces each would just equal 3,000 pounds), 100 tubs will be required. Suppose, however, that the weight per piece increases to 2.5 ounces, and causes total weight of the mail (of the same 24,000 pieces) to increase to 3,750 pounds. This mailing then will fill 100 tubs to capacity, and create another 100 tubs containing 7.5 pounds per tub. Here, in this particular example, the number of tubs that must be handled has

¹⁹ For any given density, cube increases proportionately with weight. The example is easier to follow using weight as a proxy for cube.

suddenly doubled because of the extra weight (and bulk). At this point, all of the additional tubs again will have excess capacity until weight of the mailing exceeds 6,000 pounds, when an additional 100 tubs will be required. The situation is one of small economies of scale **within a very limited range**, offset by a sharp, discontinuous **dis-economies of scale**. Overall, the situation is one of constant returns to scale.

For the concept of economies of scale to have any significance within a cost and ratemaking framework, the Postal Service must be able effectively to realize such economies in operation. Under the circumstances at issue here, this means that unit cost must decline with an increase in weight, starting with the weight currently handled. In FY 1998, the total weight of ECR flats was 4.2 billion pounds, the total weight of all Standard A commercial non-letters was 7.7 billion pounds, and the total weight of all Standard A non-letters was 8.1 billion pounds.²⁰ At these weight levels, it is quite a bold assertion to say, as witness Crowder does, that "bulk handling costs are characterized by large scale economies." Tr. 44/19390. From an operational perspective, this assertion means that, given the current level of operation, (i) the unit cost curve would decline significantly if the average weight of mailpieces were to increase, and (ii) the Postal Service is a long way from having exhausted economies that could be achieved if the average weight of mailpieces were to increase.

However, there is no evidence that the Postal Service actually realizes any economies of scale of the type described by witness Crowder. Consider as another

²⁰

USPS-LR-I-125, G-6, p. 5.

example a Postal Service truck, which is the largest “bulk” container. Over the years, Postal Service trucks have had substantial empty, unused (excess) capacity. On casual observation, this unused capacity might lead an observer to imagine the existence of extensive economies of scale in transportation, on grounds that this unused cube could be utilized at little or no additional cost. During the last two decades, however, the total volume and weight (and cube) of mail has increased quite significantly (far more than enough to fill all the empty capacity that existed 10 years ago), yet Postal Service trucks still have considerable excess capacity.

In other words, there is no credible or visible evidence to support an inference that the increase in total weight of the mail has enabled the Postal Service to realize any meaningful economies of scale in ground transportation. Since such evidence does not exist, witness Crowder is of course unable to provide any evidence (or even examples) to support her conjectures.

With respect to the third and last of her above points concerning economies of scale in bulk handling, witness Crowder again offers no evidence or examples to support her assertion that heavier-weight flats are put in larger, more efficiently handled bulk containers (than those that are used for lighter-weight flats). Since containers within postal facilities are standardized (*e.g.*, tubs and hampers), it is difficult even to begin to perceive what practice witness Crowder has in mind.

In a burst of candor on the subject of economies of scale, witness Crowder states:

the Postal Service has really not conducted a true variability analysis for allied and dock handling operations where the majority of bulk handlings related to ECR would occur. A true variability analysis would involve a measure of the extent to which the number and type of containers vary with volume and weight and this has not been done. [Tr. 44/19391-92.]

This statement of course totally supports the position of both witness Haldi and the Data Quality Study that the Postal Service needs to conduct a non-IOCS study of the weight-cost relationship, with special emphasis on all bulk handling activities where weight is likely to be an important cost driver.

C. Witness Prescott Further Compounds the Confusion.

Rebuttal testimony by witness Prescott (MOAA, et al.-RT-1) was also designed to support the proposed reduction in the pound rate for Standard A ECR Mail. Tr. 44/19265-327. Like witness Crowder, witness Prescott also perceives the serious ambiguities and shortcomings of witness Daniel's testimony. He also labors to salvage something from the confusion surrounding witness Daniel's efforts to massage IOCS-based data. Consequently, he also undertakes to develop an alternative estimate of the weight-cost relationships within Standard A Mail. Unlike witness Crowder, however, witness Prescott (i) relies solely on witness Daniel's data, (*id.*, p. 9, fn. 9, Tr. 44/19277) and (ii) develops still more regressions based on those data for both Standard A Regular and ECR.

Witness Prescott's alternative approach tries to "determine the average cost per **pound** rather than the average cost per **piece** as witness Daniel has done in her model."

(*Id.*, pp. 11-12, Tr. 44/19279-80, emphasis in original, footnote omitted.) For Standard A Regular, his alternative develops an average cost of \$0.525 per pound plus \$0.111 per piece. For Standard A ECR he develops an average cost of \$0.176 per pound and \$0.050 per piece. Tr. 44/19280. Using witness Mayes' coverages of 1.329 for Regular and 2.088 for ECR, the indicated cost and rate for a 16-ounce piece are shown in Table 4, columns 1 and 2, respectively.

Table 4

Indicated Cost and Rate for a 16-Ounce Piece of
Standard A Mail, Based on
Witness Prescott's Regressions

	(1)	(2)	(3)
	Indicated Cost of a 16-oz piece	Indicated Rate for a 16-ounce Piece	Source: MOAA, et al.-RT-1 (Tr. 44/19280)
1. Regular	\$0.6360	\$0.8452	p. 12, Table 2
2. ECR	0.2320	0.4844	p. 12, Table 2

For Standard A Regular, witness Prescott's estimated cost is within the wide range of results developed by witness Daniel. For Standard A ECR, his cost estimate is **lower** than any developed by witness Daniel, but is **higher** than the regression estimate of witness Crowder. Witness Prescott's further regression results thus help to complete

the rich smorgasbord of costs and rates that can be drawn from witness Daniel's IOCS-based data.²¹

Witness Prescott further criticizes witness Haldi for failing to take account of excess or idle capacity. Like witness Crowder, he seems to believe that the Postal Service has large, almost unlimited excess capacity. He fails to perceive that (i) any excess capacity exists only over a very limited range, and (ii) as the weight of mailpieces increase, the existing capacity is quickly filled, **and then new excess capacity is created as additional containers are brought on line.** Studying the effect of weight on cost requires contemplation of the effect from a significant increase in the average weight of mailpieces. Any significant increase in the average weight of mailpieces will require an equally significant, almost proportional, increase in the number of containers.

D. Witness Bozzo Cannot Resuscitate Witness Daniel's Weight-Cost Analysis.

Rebuttal testimony by witness Bozzo (USPS-RT-18) attempts to resuscitate witness Daniel's weight-cost analysis. As an econometrician, he appears to be acutely aware of the shortcomings in her effort to provide Postal Service rate design witnesses

²¹ The varied results reflect the use of an array of techniques to manipulate IOCS-based data in a context for which the IOCS was never designed (*e.g.*, to ascertain how weight drives cost). Thus, the record in this docket is reminiscent of the story about interviews of prospective accountants. The applicants were asked: "How much is 2 + 2?" And the successful applicant responded: "How much do you want it to be?"

(and the Commission) with a credible estimate of the weight-cost relationships for First-Class Mail and Standard A Mail. Unlike rebuttal witnesses Crowder and Prescott, discussed *supra*, who develop their own regression analyses in an attempt to salvage some benefit from witness Daniel's IOCS-based cost data, witness Bozzo takes a very different tack. He argues that her cost data by weight increment and her efforts at regression analysis were appropriately ignored by rate design witnesses Fronk and Moeller, as they are essentially irrelevant:

[i]f anything, [variability in IOCS-based cost data] simply highlights the undesirability of excessive reliance on those individual point estimates that are subject to relatively high sampling variation — which witnesses Fronk and Moeller have avoided by considering **only trends and relationships among the data**. [USPS-RT-18, p. 7, Tr. 44/19470, Emphasis added.]

One could lose sight of the fact that neither witness Fronk nor witness Moeller relies upon the detailed costs by weight increment.... In the case of the data witness Daniel supplies to witnesses Fronk and Moeller, it is true, **but irrelevant**, that witness Daniel's data do not clearly identify the precise effect of mailpiece weight on cost in isolation from other factors. [USPS-RT-18, p. 18, Tr. 44/19481, Emphasis added.]

1. Witness Bozzo Puts Witness Daniel's Regression Results Into Appropriate Perspective.

In defense of witness Daniel's effort to analyze the weight-cost relationship using IOCS-based data, witness Bozzo states:

[witness Daniel] needed only determine the cost of the mail subject to the First-Class additional ounce rate and Standard Mail (A) piece and pound rates in the aggregate. [USPS-RT-18, p. 18, Tr. 44/19481.]

When questioned about this statement concerning the sufficiency of aggregate data and the role of witness Daniel's regression models, witness Bozzo characterizes her regressions as "superfluous." Tr. 44/19513.

Q: If all that witness Daniel need do was make these calculations in the aggregate, why do you think she made so many regressions in her Library Reference 92? Why did she compute so many different regressions?

A: That would be a question for Witness Daniel.

Q: Totally unnecessary, in your opinion?

A: I believe that, given the data that Witnesses Fronk and Moeller employed in their implicit cost coverage analyses, the trend lines that she produced were superfluous.

If witness Daniel's regressions were superfluous, then virtually all of USPS-LR-I-92 is equally superfluous to the defense (or development) of a reduced ECR pound rate. Although not asked to comment specifically about the regression results of witnesses Crowder and Prescott, witness Bozzo's views would seem to apply with equal force, since neither witness Fronk nor witness Moeller were aware of these other, later salvage efforts when they prepared their direct testimony. Witness Bozzo's testimony at least has the merit of clarifying the confusion emanating from the many regression results bandied about by various parties — namely, that they all should be ignored.

2. The Commission Needs More Than Trends and Relationships To Develop Cost-based Pound Rates.

As noted above, witness Bozzo points out that rate design witnesses Fronk and Moeller considered "only trends and relationships among [witness Daniel's IOCS-based

cost] data.” One probable reason is the numerous infirmities revealed by the data when they are subjected to close analysis.

As one example of a totally counter-intuitive “trend and relationship” among witness Daniel’s regression results, the unit cost for Standard A Regular parcels decreases as weight increases; *see USPS-LR-I-92*, Section 1, page 21. Since USPS-LR-I-92 contains virtually no discussion or analysis, no effort is ever made to explain such anomalous, irrational results. Should the Commission rely on these data, and impose a high unit rate that decreases as weight increases?

As another example, all of witness Daniel’s data and regressions for Standard A nonprofit mail **consistently** show a higher unit cost when compared to comparable regressions for Standard A commercial mail. The fact that data for nonprofit Standard A Mail are more sparse than the data for commercial Standard A Mail does not explain why the computed costs are **consistently** higher, as sparse data could just as well produce lower costs. For many years, in fact, nonprofit mail has reported lower unit costs than the corresponding categories of commercial mail. These incongruous results are summarized below in Table 5.

Good studies do not produce irrational results, and studies which produce or support irrational results are not good studies, even if they can be used to support desired results. If witness Daniel’s data are adequate to establish meaningful “trends and relationships,” surely these rather astounding results for nonprofit mail must also be taken into account. One approach would be to combine commercial and nonprofit tallies from each corresponding subclass (which has not been done). That would help

reduce the problem occasioned by “thinness” of tallies in the heavier weight increments. Of course, at the same time it would almost surely increase the indicated per-pound cost, since witness Daniel’s nonprofit cost trends are uniformly higher than the corresponding commercial cost trends.

The Commission should not reward the practice of spewing out data and regression results, to facilitate the selective adoption of certain “trends and relationships” while rejecting others — particularly where, as in this docket, **no explanation or justification** is given as to why **certain** IOCS-base data are deemed reliable while **other** comparably-generated data are ignored as unreliable and unacceptable.

Table 5

Indicated Cost for a 16-Ounce Piece of
Standard A Commercial and Nonprofit Mail,
Based on Witness Daniel's Regressions

	(1) Commercial	(2) Nonprofit	(3) Col. 1 Source ¹	(4) Col. 2 Source ¹
Detailed Half-ounce Increments:				
Regular/Nonprofit:				
1. All shapes	\$0.8008	\$1.1072	1, p. 10	3, p. 10
2. Flats	0.3652	0.7592	1, p. 16	3, p. 16
ECR/NECR:				
3. All shapes	0.3198	6.8934	2, p. 10	4, p. 10
4. Flats	0.2745	1.5708	2, p. 17	4, p. 16
Combined Weight Increments:				
Regular/Nonprofit:				
5. All shapes	0.7180	0.9921	1, p. 12	3, p. 12
6. All Flats	0.3409	0.7241	1, p. 18	3, p. 18
ECR/NECR:				
7. All shapes	0.2833	0.3555	2, p. 10	4, p. 12
8. Flats	0.2517	0.6320	2, p. 16	4, p. 18

¹ USPS-LR-I-92 is the source for all data; the first number indicates the section.

3. The Criticisms of Witness Haldi's Analysis of IOCS-Based Data Miss the Mark.

Witness Haldi critiques the Postal Service's effort to study the weight-cost relationship and states his opposition to the proposed reductions in the ECR pound rate based on the evidence in this record.²² Witness Bozzo attacks witness Haldi's critique of the Postal Service's use of IOCS data to analyze costs by weight increment within subclasses. (Tr. 44/19460-83) However, witness Bozzo's rebuttal misunderstands or misrepresents some of witness Haldi's observations, while others are entirely ignored.

In the first place, witness Bozzo acknowledges that over 50 percent of all tallies indicate that the clerk or mailhandler was not handling mail. Tr. 44/19502. In many instances, the clerk or mailhandler is working productively, but not handling mail, while in others the tallied clerk or mailhandler is on some kind of break. Of those tallies where the clerk or mailhandler was handling mail, about 20 percent are recorded as mixed tallies, where weight of the mailpieces is not known. Tr. 44/19504. Direct tallies thus represent only 80 percent of 50 percent, or 40 percent of all tallies. About 90 percent of all direct tallies record weight of the mailpiece. Tr. 44/19502. Thus, only about 90 percent of 40 percent, or 36 percent, of all tallies contain information about the weight of the mailpiece. This means that (i) nearly two-thirds of all tallies lack meaningful information that can be used to determine the relationship between

²² The Postal Service's efforts to capture the relationship of cost and weight within Standard A Mail is critiqued in Appendix B of witness Haldi's testimony, VP/CW-T-1, pp. B-1 through B-28, Tr. 32/15823-50.

weight and costs, and (ii) about two-thirds of all costs must be distributed to weight increment by means of a proxy.

The use of direct piece-handling tallies (which show little relationship between weight and cost) to distribute mixed mail tallies between weight increments can mask any relationship between mailpiece weight and movement of containers containing mixed mail. Containers such as hampers generally contain commingled mailpieces of varying weight. Since IOCS does not count and list contents of a container by weight, no credible basis exists for allocating such mixed mail tallies between weight increments. VP/CW-T-1, pp. B-13 through B-14, Tr. 32/15833-34.

Witness Bozzo defends the methodology used by the Postal Service in this docket, describing it as an improvement over witness McGrane's methodology, which was used for a weight-cost study in Docket No. R97-1. Tr. 44/19469. In this docket, the costs of tallies where no weight is recorded, but shape and activity are known, are distributed in proportion to the weight-cost relationship of direct tallies for each MODS activity. Tr. 44/19468. The assumption used by witness Daniel in this case may be slightly less presumptuous than the LIOCATT method used in Docket No. R97-1, and since abandoned, as witness Bozzo notes (Tr. 44/19469), but it nevertheless remains an heroic leap of faith. The assumption is even more heroic for tallies where neither weight nor shape is known (*e.g.*, tallies where the clerk or mailhandler is doing other performing productive work, such as moving empty equipment, but is not handling mail). The fact remains that the Postal Service knows what it knows solely based upon direct tallies. All other tallies do not improve the information base with respect to

weight by one iota,²³ and all costs associated with all non-direct tallies (over 60 percent of all costs) are distributed in exact proportion to the direct tallies (by activity, to be sure). Tr. 44/19468. The methodology ensures that the distribution of costs by weight increment will always be proportional to direct tallies.²⁴ Although this assumption lies at the very heart of the Postal Service's methodology, the Postal Service has no analysis whatsoever (*e.g.*, of not handling tallies within various activities that involve extensive bulk handling) or other evidence to support the use of such a proxy.

Witness Bozzo observes that the IOCS infers the "likely" contents of the container by weight and subclass, and states that direct tallies representing single piece handlings would be used to distribute mixed-mail tallies "for observations of loose mixed pieces of the same shape (as might be found in a hamper, for example)." Tr. 44/19467. Not the same weight, or even subclass — just the same shape. He further explains that "[s]ince the equipment being handled is usually associated with a shape, such as a letter or flat tray, and shape conveys information on weight, there is a reasonable basis for inferring the weight distribution of the mixed-mail observations." *Id.*

²³ Imagine the chaotic result if an analyst tried to develop some kind of weight-cost relationship using only the IOCS tallies that do not indicate weight.

²⁴ Short of studying what actually happens, which the Postal Service steadfastly continues to resist, it is difficult to conceive of any other methodology to use under the circumstances, where so much cost is associated with tallies where no weight has been recorded.

When asked on oral cross-examination how shape conveys information regarding weight, witness Bozzo explained that a flat tally would indicate a mailpiece that is probably heavier than a letter, and that the IOCS would thereby infer a “likely distribution of weight.” Tr. 44/19507. This comports with witness Daniel’s observation that IOCS data are “not specifically designed for the purpose of measuring the impact of weight on costs.” USPS-T-28, p. 4, ll. 24-25, *quoted in* VP/CW-T-1, p. B-2, Tr. 32/15824. Yet the allocation of such IOCS tallies to various weight increments supplies the detail undergirding witness Daniel’s analysis, presented in this docket in an attempt to justify the Postal Service’s proposed reduction to the pound rate.

Witness Bozzo concludes that some not handling activities are not worthy of consideration, while it is sufficient that other such activities be reflected in the proper operational cost pool. USPS-RT-18, pp. 5-6, Tr. 44/19468-9. Neither response addresses the concern raised by witness Haldi — that the allocation of such costs by weight increment is inaccurate, and subject to systemic bias. Thus witness Bozzo asserts — but fails to demonstrate — that these “shortcomings of a mail processing cost distribution system ... have been overcome in the Postal Service’s MODS-based cost distribution approach.” *Id.*, p. 6, Tr. 44/19469. Analyzing IOCS data by MODS activity clearly does not constitute a redesign of IOCS for the purpose of measuring the impact of weight on costs.

4. Witness Bozzo Fails to Address the Anomalous Changes in Marginal Cost Differences Throughout Witness Daniel's Data.

Witness Haldi uses the statistical concept of “link relatives” to illustrate anomalies in witness Daniel's IOCS-based data. Specifically, he uses data for Standard A ECR letters to illustrate the point. VP/CW-T-1, pp. B-23 through B-25, Tr.

32/15845-47. *Witness Bozzo criticizes the illustration, and states:*

The problem is not with IOCS, *per se*, but slicing the data too thinly. That there should be a relatively high degree of sampling variation in the cost estimates for the remaining 0.2 percent slice of the ECR letter volume hardly indicts the Postal Service's cost systems as a whole. [USPS-RT-18, pp. 6-7, Tr. 44/19469-70.]

Witness Bozzo's criticism is valid, insofar as it goes, but he pointedly ignores the anomaly between 2.5 and 3.0 ounces in the half-ounce letter data shown in witness Haldi's Table B-3. Tr. 32/15847. More importantly, witness Bozzo ignores the fact that cost data for letters were simply one illustration of a rampant problem that exists throughout witness Daniel's data.

Link relatives are nothing more than successive “marginal cost differences” for successive weight increments. These differences are shown as the bottom row in each table in USPS-LR-I-92. No additional computations are necessary. In each of witness Daniel's tables, one need only count the negative entries shown in the bottom row, which is labeled “Marginal Cost Differences.” Table 6, column 1, summarizes the anomalous results for Standard A Regular and ECR, derived from her tables for “All Shapes” and “Flats.” Marginal cost differences from tables devoted only to “Letters” or “Parcels,” where thinness of tallies can be a significant problem, are omitted. By

focusing myopically on one example in witness Haldi's testimony, and failing to examine witness Daniel's data even cursorily, witness Bozzo misses the point entirely. In almost every instance where anomalies crop up, presumably her data are either too thin, or the size of the IOCS sample is too small.

The problem of thinness of data is not a new issue, and it is too important to be ignored, as witness Bozzo has done. In its *Opinion and Recommended Decision* in Docket No. R97-1, the Commission stated, "[t]he thinness of the tallies supporting the distribution of mail processing cost by weight increment presents a serious problem." *Id.*, para. 5419. Subsequently, the Data Quality Study stated that:

The thinness of the data is a concern. Weight information can only be obtained from mail that is identified individually, which is now less than half of all IOCS tallies. As information is needed on many weight categories, each category may have extremely small samples resulting in large sample variations. The difficulties with small sample sizes are most noted at the low and high end of the weight spectrum for a particular sub-class. [USPS Data Quality Study, April 16, 1999, Summary Report.doc, p. 93.]

To sum up, witness Bozzo (as well as other intervenor witnesses) attempts to defend witness Daniel's methodology by lauding the various refinements (such as MODS) adopted since the ill-fated study by witness McGrane in Docket No. R97-1. Not mentioned are the facts that (i) the size of the IOCS sample has not increased, (ii) the proportion of direct tallies that actually record weight of the mailpiece has not increased, and (iii) thinness of tallies and anomalous results are as rampant as ever.

Table 6

Anomalies in Witness Daniel's IOCS-Based Data

	(1)	(2)	(3)
	Number of Weight Increments With Negative Marginal Cost Difference	Total Number of Computed Marginal Cost Differences	Source: Section/ Page of USPS- LR-I-92
Standard A Regular Mail:			
Half-ounce increments:			
All Shapes	5	19	1/10-11
Flats	10	19	1/16-17
Combined weight increments:			
All Shapes	0	8	1/12
Flats	4	8	1/18
Standard A ECR Mail:			
Half-ounce increments:			
All Shapes	5	19	2/10-11
Flats	6	19	2/17-18
Combined weight increments:			
All Shapes	1	8	2/12
Flats	2	8	2/19

E. Witness Bradpiece's Limited Experience With Alternate Delivery Sheds No Light on the Standard A Mail Weight-Cost Relationship.

Testimony by Saturation Mail Coalition witness Bradpiece (SMC-RT-1, Tr. 44/18908-22) was designed to show that the Postal Service's pound rate exceeds the rate that can be obtained from a private delivery company. Although well-intentioned, his testimony does not shed any light on the cost-weight relationship for Standard A ECR Mail, nor does it provide any basis for recommending witness Moeller's proposed reduction in the pound rate.

Witness Bradpiece testifies that, a few weeks before preparing his testimony, he acquired the assets of a company in Buffalo, New York. This company included, among other enterprises, both a private distribution company and a newspaper distributed free to residents of Erie and Niagara counties. Tr. 44/18925 and 18937.

Witness Bradpiece is quite candid about the fact that the company was losing money immediately prior to the time when before he acquired the assets, with IRS problems and a pending bankruptcy. He also states that he intended for his subsidiary distribution company to operate profitably (*i.e.*, it was not his intent to have the delivery rates cross-subsidize the newspaper), but he admits that he does not yet know if it in fact has been operating profitably at the rates charged. Tr. 44/18972-3.

According to witness Bradpiece, the distribution company uses part-time employees exclusively (including supervisory employees), and pays the 1,100, or so, people who deliver the newspaper and accompanying inserts a flat rate per piece, regardless of the weight of any individual insert, or the weight of the package.

Tr. 44/18913. The carrier force is paid only those benefits that the law requires, such as Social Security, and does not receive any paid health, sick leave, retirement, or vacation benefits. Tr. 44/18970. When any of his carrier force use vehicles to deliver their route, it is at their expense. Tr. 44/18943. Witness Bradpiece's testimony establishes that in Buffalo he has a successful, low-cost delivery operation in comparison to the Postal Service. In this respect, his testimony provides strong support for not increasing the level of ECR rates. At the same time, he obviously does not know whether weight adds anything to the time required to assemble and deliver his weekly package of newspapers and inserts. To the extent that it does, his employees are forced to put in the extra time with no additional compensation. His testimony clearly is not applicable to the weight-cost relationship within the Postal Service, which pays its employees by the hour, not by the piece.

F. The Commission Needs a Credible Study of the Effect of Weight on Cost.

Two principal rate making characteristics for every class of mail are volume and weight (distance is also an important consideration for zoned parcel categories).

Weight plays an important role in every chart of Postal Service rates. The need for a more informative and more credible study of the relationship between weight and cost should be therefore should be self-evident. Certainly it is not new. In its *Opinion and Recommended Decision* in Docket No. R97-1, the Commission stated:

The Commission finds the lack of a reliable cost-weight study to be singularly frustrating. The Service has submitted the same basic cost study to the Commission

since 1982, despite Commission requests for a more comprehensive analysis. Tr. 34/18315. In Docket No. R87-1, the Commission requested that the Postal Service conduct a study of the cost effect of changes in weight per piece. PRC Op. R87-1, Appendix K, para. 001. In Docket No. R90-1, the Commission repeated the request, emphasizing that this area of inquiry remained largely unexplored.... Yet, as Crowder shows, the Service continues to introduce the same type of limited study.²⁵ [*Id.*, para. 5423.]

Witness Daniel's data and analyses in this case are subject to severe infirmities of the type that have plagued all previous IOCS-based studies.²⁶ The Postal Service's effort in this docket is so adamant in the face of the Commission's prior repeated requests that one can reasonably begin to suspect that the Service has no desire to determine how weight affects costs.

The relationship between weight and cost conceivably can be studied in a number of different ways. Witness Haldi suggests a modeling effort that would "focus study on the cost of those non-piece handling functions that it has not yet modeled." VP/CW-T-1, p. B-26, Tr. 32/15848. The Postal Service has successfully modeled the cost avoidance of mail that is dropshipped to destination entry points, and it has extensively modeled and analyzed the cost of bundle handling operations. The Postal

²⁵ As Yogi Berra said, "It's *déjà vu* all over again."

²⁶ The Data Quality Study observes that such severe problems are inherent in any analysis based solely on IOCS data. Moreover, they have worsened since 1982. First, size of the IOCS sample was sharply reduced in the early 1990s. Second, automation has significantly reduced the percentage of direct tallies where weight is recorded, and with continued automation the percentage is likely to decline further.

Service also has extensively modeled piece handling for flats.²⁷ This model (i) identifies the piece-handling operation, (ii) estimates the cost of these operations, and (iii) distributes the cost of those operations on a per-piece basis. The Postal Service makes no effort to explain why it cannot identify and estimate the cost of bulk handling operations.²⁸

The Data Quality Study (p. 94) has also recommended that the Postal Service “[d]evelop engineering studies that track weight in conjunction with other mail cost-causing characteristics through the entire production process.”

The Commission may be growing weary of the routine of demands for a lower pound rate supported only by wholly inadequate and inconsistent contrived data (and warnings that the sky is falling). Under such circumstances, there may be a strong temptation to settle for the evidence offered while granting the importunate request. Nevertheless, we call on the Commission to withstand this temptation, and remain faithful to its statutory duty to act on only credible record evidence. If the Postal Service’s plea is again rejected, it will have no one to blame but itself.

²⁷ See, for example, USPS-LR-I-90, Flats Mail Processing Cost Model.

²⁸ In order to achieve the results which she desires in this case, witness Crowder would have the Commission overlook the severe infirmities in witness Daniel’s data and analyses, asserting that “[i]t would be exceptionally difficult (if not impossible) to identify system-wide, rate-category-specific, weight-related costs through an industrial engineering, modeling or some other non-IOCS-type approach.” Tr. 44/19393.

III. THE POSTAL SERVICE'S PROPOSED COST COVERAGE FOR STANDARD A ECR SHOULD BE REDUCED.

A. Witness Haldi's Proposal to Moderate the Cost Coverage and Unit Contribution from Standard A ECR is Well Supported.

Witness Haldi proposes a reduction in the cost coverage on Standard A ECR to 202 percent. Only a minor reduction in cost coverage was selected to avoid possibly adverse effects of rate increases on other classes and subclasses that could flow from a greater reduction. At the same time, it provides a minimal, symbolic representation of a long-term commitment to reduce the cost coverage on Standard A ECR, hopefully, to the point where its **unit contribution** is comparable to that of Standard A Regular. The rates that result from a slightly reduced coverage are consistent with the criteria contained in 39 U.S.C. section 3622(b). VP/CW-T-1, pp. 54-55, Tr. 32/15808-09.

Witness Haldi proposes rates that reflect (i) a passthrough of 85 percent for destination entry discounts, (ii) a pound rate of \$0.661, and (iii) an adjustment for mismatches by shape between the RPW and the IOCS. *Id.*, p. 30, ll. 1-5, Tr. 32/15784. Witness Haldi's proposed rates would raise \$5,106 million in revenue, \$177 million less than the Postal Service's proposed rates. *Id.*, p. 29, Tr. 32/15783. These proposals should be recommended.

1. Comparison of the Average Unit Contributions by Standard A Regular and ECR Support a Lower Markup for ECR.

It is instructive to compare the average unit contributions from Standard A ECR and Regular. Under the Postal Service's proposal, the average Test Year After Rates

unit contribution for ECR would be 2.7 cents higher than for Regular.²⁹ *Id.*, p. 38, Tr. 32/15793-94; *see also* Appendix C. For FY 2000 and TYBR the average unit contributions from ECR are estimated to be more than twice as large as Regular. Appendix C, Table C-1, Tr. 32/15792.

Interestingly, witness Mayes observed generally that the cost coverage of more highly prepared mail categories must be increased so as to ensure that they generate the **same contribution** to institutional costs as the less workshared categories. USPS-T-32, p. 10. However, this general principle has no application within the Standard A class. The cost coverage of Standard A ECR is so high, its unit contribution has grown to be substantially higher than that of Standard A Regular. VP/CW-T-1, pp. 39-40, Tr. 32/15793-94.

Witness Haldi set out the unit contributions for Standard A ECR and Regular Mail for FY 1997-2001 (TYBR and TYAR), together with the Commission's estimates in the last omnibus rate case, Docket No. R97-1. Unit contributions from ECR have remained consistently within a spectrum of 7.5 to 8.7 cents during this five-year span, while unit contributions from Regular have dropped nearly by half — from 7.3 cents in FY 1997 to 3.8 cents in FY 2000 (with a further drop to 3.6 cents Test Year Before

²⁹ The data in witness Haldi's direct testimony reflect Test Year costs derived from the roll-forward model using Base Year 1998. Using FY 1999 as the Base Year, the ECR unit cost is 1.7 cents more than the average Regular contribution under proposed rates.

Rates).³⁰ For Test Year After Rates, unit contributions are estimated to be 8.2 cents for ECR, and only 5.5 cents for Regular.³¹ *Id.*, pp. 42-43, Tr. 32/15796-97.

The divergence in unit contributions between ECR and Regular was wholly ignored by the Postal Service in its case-in-chief. The failure to raise Regular rates to cover adequately increases in Regular unit costs causes the burden of institutional contributions to be shifted to other subclasses such as ECR, where costs have remained more controlled (due to the smaller degree of utilization of the postal network). In addition to considerations of fairness, criterion 1, this dynamic creates a perverse incentive for mailer worksharing, inconsistent with criterion 6 (degree of mailer preparation). *Id.*, p. 45, Tr. 32/15799.

The unit contribution differential between ECR and Regular recommended in Docket No. R97-1 was 2.1 cents. According to Postal Service estimates, the differential will increase to an estimated 4.2 cents in FY 2000. Witness Haldi observes that, should the Commission recommend the Postal Service's proposed rates, given current cost trends, the unit cost differential could double again before the next rate case. *Id.*, p. 46, ll. 1-11, Tr. 32/15800.

³⁰ TYBR revised using FY 1999 data as Base Year indicate a unit contribution of 4.4 cents for Regular, up slightly from FY 2000, but still well below the unit contribution of ECR.

³¹ Using FY 1999 data as the Base Year for the roll-forward model, the Test Year after rates unit contributions for ECR and Regular are 8.0 and 6.2 cents, respectively.

While the unit **contribution** from ECR is substantially more than the unit contribution from Regular, the unit **cost** of Regular is consistently more than twice the unit cost of ECR.³² Since Regular incurs much higher unit costs, while providing a lower unit contribution, the Postal Service's efforts to promote Regular volume at the expense of ECR volume result in spending more to earn less. Specifically, in FY 1999, the Postal Service incurred only \$2.3 billion in ECR costs to obtain a contribution of \$2.5 billion, while it spent \$5.9 billion in Regular costs to obtain a contribution just over \$2 billion. *Id.*, pp. 48-50, Tr. 32/15802-04.

Witness Tolley calculates that demand for ECR is 1.4 times as price sensitive as demand for Regular. USPS-T-6, pp. 115, 132. Thus, a rate increase by the same percentage would **reduce** ECR volume by 1.4 times as much as Regular volume. Conversely, the same percentage rate would **increase** ECR volume by 1.4 times more than Regular volume. The high elasticity of ECR reflects a mail product with both a low value of service and ready availability of alternatives. The Postal Service's proposed increase in the ECR cost coverage, which disproportionately restricts growth in a subclass that has a particularly favorable ratio of contribution to cost, is a very unbusinesslike decision. When setting rates, the Commission should consider whether such rate requests sustain the long-term financial viability of postal operations. *Id.*, pp. 51-52, Tr. 32/15805-06.

³² Table 6 of witness Haldi's testimony presents the unit costs for Regular and ECR for FY 1997-2001 (TYBR and TYAR), as well as from the Commission's estimates in Docket No. R97-1. Tr. 32/15804.

2. Application of the Section 3622(b) Non-cost Criteria to Standard A Regular and ECR Unit Contributions Supports a Reduction in the ECR Markup.

There are two methods of analyzing institutional contributions: (i) unit contributions and (ii) cost coverages. The non-cost criteria of § 3622(b) should apply equally to both methods. The Commission has preferred to use coverages as a means of explaining its recommendations, but an examination of unit contributions demonstrates in stark terms that the institutional burden being placed on ECR is excessive. VP/CW-T-1, p. 38, ll. 14-20, Tr. 32/15972.

The practice of assigning particularly high institutional cost burdens to ECR dates from the creation of the subclass in Docket No. MC95-1. In Docket No. R97-1, Postal Service witness O'Hara agreed that three of the eight section 3622(b) non-cost criteria, nos. 2, 5, and 6, support a lower contribution from ECR — and that analysis remains valid in this docket. USPS-T-30, pp. 34-36, Docket No. R97-1. It is acknowledged that if ECR contributions were reduced, it would have an adverse effect on other classes and subclasses (criterion no. 4). However, since Docket No. MC95-1 (at least in the eyes of the Postal Service), criterion 4 has totally overridden criteria 2, 5, and 6, resulting in the over-assignment of institutional costs to ECR. VP/CW-T-1, pp. 40-44, Tr. 32/15794-98. (Val-Pak and Carol Wright ask the Commission to continue their moderation of the high ECR cost coverage when setting recommended rates in this docket.)

ECR and Regular have identical service standards and priorities, and are both predominantly advertising mail. The primary demand difference is that Regular is

more suited towards demographic targeting, where ECR is more suited to geographic targeting. Nevertheless, despite the similarities, Regular will always have higher unit costs because it requires more handling by the Postal Service. Under the efficient component pricing principle for monopoly bottleneck pricing, comparable products should have unit contributions that are roughly equal. The current widely divergent unit cost contributions of Regular and ECR border on an anomaly in the rate structure, and cannot reasonably be regarded as reflecting proper consideration of criterion 1, *Fairness and Equity*. Nor are these respective contributions consistent with the Commission's principle of rough comparability among rates of comparable classes or subclasses. *Id.*, pp. 46-47, Tr. 32/15800-1. Further moderation of ECR's cost coverage is needed.

The purpose behind the non-cost criteria (particularly criterion 4, the effect on mailers) was not to turn the Postal Service into a welfare agency which uses a few subclasses to nurture and support high-cost categories of mail. Such an application of the non-cost criteria would not be fair and equitable (criterion 1) to those subclasses carrying an excessively heavy burden. There should be a long-term ratemaking goal of reducing the cost coverage of ECR relative to Regular (long-term, so as to avoid highly disruptive effects on users of other mail products). *Id.*, pp. 52-53, Tr. 32/15806-07.

Lastly, many of the irrationalities of the current rate proposal by the Postal Service are the product of its inability to control costs (particularly costs of handling nonletters). The resultant cost imbalances have led the Postal Service to seek to manipulate its rate structure in an effort to soften the impact of its more critical

inefficiencies. However, greater success at cost control could certainly facilitate reduction in the ECR-Regular unit contribution gap. *Id.*, p. 53, Tr. 32/15807-14, ll. 14-21.

B. Witness Clifton's Proposal to Increase Standard A Rates in Order to Reduce First-Class Rates Should Not Be Recommended.

Witness Clifton (ABA/NAPM-T-1, Tr. 26/12393-557) proposes that (i) the additional ounce rate for First-Class Mail be retained at 22 cents, (ii) various First-Class Mail worksharing discounts be increased beyond the level proposed by the Postal Service, and (iii) the heavy piece discount be applied to two-ounce First-Class presort mailpieces. Witness Clifton estimates that his proposals would reduce Test Year revenues from First-Class Mail by \$605 million (*Id.*, p. 57, Tr. 26/12457), and proposes that the associated revenue loss be made up by increasing rates for Standard A Regular and ECR Mail by 0.645 cents.³³

A central theme of witness Clifton's testimony is the reduction of the institutional contribution from First-Class Mail — especially First-Class Presort Mail, and particularly vis-a-vis the Standard A Commercial subclasses. His proposed discounts would reduce the implicit cost coverage of the First-Class Presort Mail rate

³³ ABA/NAPM-T-1, p. 63, Tr. 26/12463. Witness Clifton, in his supplemental testimony (ABA/NAPM-ST-1, p. 17, Tr. 45/20101) states that he has reduced his proposed increases to the "Standard A Regular ... subclasses." [sic]

Witness Clifton offered two other options for "financing" his proposed First-Class Mail discounts: reducing the Postal Service's contingency in half; or some combination of reductions in the contingency and increases to Standard A Commercial rates. ABA/NAPM-T-1, p. 63, Tr. 26/12463.

category by 8.0 percent, and the overall cost coverage of First-Class Mail by 2.8 percent. ABA&NAPM-T-1, p. 57, Tr. 26/12457.

Witness Clifton cites the *Opinion and Recommended Decision* in Docket No. R90-1 for the proposition that the Commission has had the goal of keeping the overall markup of First-Class Mail near the systemwide average. He observes that the implicit markup for First-Class presort mail rate category has continued to rise above the systemwide average since FY 1994. He then contrasts the markup for Standard A Regular, which has dropped below the systemwide average over the same span, and asserts that this treatment of Standard A Regular and First-Class presort mail is contradictory to the Commission's "long-term goals" as expressed in the Docket No. R90-1 *Opinion and Recommended Decision. Id.*, p. 58

Witness Clifton next compares the markup of the First-Class presort mail rate category to that of the Standard A ECR subclass. He asserts that ECR's markup has tended towards the systemwide average while the First-Class presort rate category has seen its implicit markup increase. However, witness Clifton carefully avoid mentioning the Base Year data — where the ECR markup approached the implicit markup for First-Class presort.

Witness Clifton also attacks the markup of the First-Class single piece rate category, which hovered around the systemwide average. He asserts that these changes in markup both are discriminatory towards First-Class mailers and reflect a tendency explicitly rejected by the Commission in Docket R90-1. ABA/NAPM-T-1, pp. 58-60, Tr. 26/12458-60.

Lashing out in all directions, witness Clifton observes that First-Class presort “is supposed to be part of a single First-Class letters subclass,” accusing the Postal Service of having “singled out” the workshared component “in an arbitrary and almost punitive way,” resulting in “unfair, inequitable, and discriminatory treatment towards the mailers whose substantial investments and ongoing dedication now move 45 billion pieces of First-Class Mail through automated processing technology annually.” *Id.*, p. 60, Tr. 26/12460. Despite his fulminations, he did not propose to increase the rate for non-workshared First-Class Mail (*i.e.*, single-piece First-Class Mail) and use any of the proceeds to cure his perceived inequity.

Finally, witness Clifton discusses the attribution of delivery costs, almost 49 percent of which are identified as institutional. He states that application of cost coverage to each subclass’s total attributable costs (rather than to the “individual postal services” received by that subclass) penalizes First-Class Mail, to the benefit of the Standard A class. Witness Clifton concludes that an increase to the Standard A cost coverage, and decrease to that of First-Class, is “the only practical way to confront the problem, short of instituting separate cost coverages” (*e.g.*, for delivery, mail processing, etc.). *Id.*, pp. 61-62, Tr. 26/12461-62.

, 1. Witness Clifton Ignores All Non-Cost Criteria in the Act Except One.

Witness Clifton testifies:

Because cost coverages are not determined by individual postal service but by a single mark-up over the attributable costs of all services, First Class Mail, and workshared mail in particular, has been shouldering an extremely unfair share of institutional delivery costs for several

years, while Standard A mail has **unfairly** benefitted from this cost coverage convention. [ABA&NAPM-ST-1, p. 60, Tr. 26/12460, emphasis in original.]

By raising questions of “fairness” in his comparison of the cost coverage of Standard A Mail with that of First-Class Mail and its rate categories, witness Clifton is clearly relying on the non-cost fairness and equity criterion contained in section 3622(b)(1) of the Postal Reorganization Act. Witness Clifton mentions the non-cost criteria as one of the “analytical inputs” animating his proposal, yet the criteria receive no attention in his testimony. Tr. 26/12659-60.

In consideration of some of those other criteria, however, it is clear that Standard A Mail has a much lower value of service than First-Class Mail (section 3622(b)(2)). *See* VP/CW-RT-1, pp. 6-7, Tr. 44/18852-53. First-Class Mail is treated as urgent mail, has its delivery performance monitored, receives air transportation, has full access to the collection system, and receives free forwarding and return service. Standard A Mail is viewed as non-urgent, does not have its delivery performance monitored, receives ground transportation almost exclusively, must be presented at designated postal facilities, and does not receive free forwarding and return service.

Although published standards for Standard A Mail are the lowest — 2-10 day delivery standard, subject to deferral at each stage of processing and delivery — the actual service received by Standard A Mail is even lower. Standard A mailers report that the amount of time required to deliver Standard A Mail can be and is subject to a wide range of uncertainty. It can be 15-20 days before Standard A Mail (when

traveling long distances) receives delivery. Given the possibility of deferral, each intervening stage of processing adds uncertainty as to when the mailpiece will reach the addressee. *Id.*, pp. 6-9, Tr. 44/18852-55.

Thus, witness Haldi observes that day-certain delivery would be of far greater value to Standard A mailers than the 6-day a week delivery currently provided. The great uncertainty with regard to actual delivery complicates efforts to coordinate advertising mail with sales promotions using other media (such as television and radio) as well as preparations to respond to increased demand. Alternate delivery systems which deliver advertising pieces only 1-3 days a week may provide advertisers with service that not only is superior to, but also less costly than, that available through the mail. *Id.*, pp. 9-10, Tr. 44/18855-56.

Likewise, section 3622(b)(6), degree of mailer preparation, heavily favors not loading institutional costs on those mailers who enter highly prepared mail such as ECR. With regard to witness Clifton's comparisons between First-Class Mail and Standard A unit contributions and markups, the Standard A ECR subclass requires a higher degree of preparation than any First-Class Mail subclass, yet this consideration is also conspicuously absent from witness Clifton's deliberations. In the absence of any considered comparison of the non-cost factors of the Act, witness Clifton's coverage proposals for Standard A Mail should be rejected out of hand.

2. Witness Prescott Also Probed Limitations and Revealed Defects in Witness Clifton's Testimony.

Witness Prescott's rebuttal testimony (MOAA, et al.-RT-1, Tr. 44/19313-20) also criticizes witness Clifton's proposal. Witness Prescott observes that much of the increase in First-Class presort's markup is due to decreases in attributable costs, rather than to increases in First-Class Mail rates. In fact, the average revenue per piece for First-Class presort would increase only 7.9 percent from 1994 to TYAR, under the Postal Service's proposed rates (an annual increase of approximately 1 percent — a decrease in actual terms, when adjusted for inflation). MOAA, et al.-T-1, p. 47, Tr. 44/19315. Witness Prescott observes that the Commission has anticipated, and does not object that when a mail product's costs decrease over time, its markup may increase as a result. *Id.*, pp. 47-48, Tr. 44/19315-16.

Witness Prescott next shows, by comparison, that under the Postal Service's proposed rates the average revenue per piece of ECR mail would increase by 19.1 percent during the period 1994-TYAR, which is more than double the increase in the rates for First-Class presort during the same seven year period. He observes as well that the growth in contribution to institutional costs over this time period is comparable for both ECR and First-Class presort. *Id.*, pp. 48-49.

C. Witness Tye's Proposed Increase to Standard A ECR Rates Should Be Rejected.

Witness Tye (NAA-T-1, Tr. 30/14687-771) also seeks to increase the rates for Standard A ECR Mail. To support his proposed increase, he cites several factors,

including (i) anomalous passthroughs, (ii) failure to consider unit contributions between similar subclasses, and (iii) a potential revenue shortfall arising from the way “after rates” volume forecasts are developed. He says that witness Mayes selected a 4.9 percent rate increase for ECR in part to lower the very high cost coverage of the subclass, ignoring the difference in unit contributions between ECR and First-Class Mail. *Id.*, pp. 23-24, Tr. 30/14713-14.

1 An Unwarranted General Rate Increase Is Not the Way to Cure Anomalous Passthroughs.

Witness Tye claims that the Standard A rate design contains “anomalies” due to a reduction in the ECR cost coverage. *Id.*, pp. 27-28, Tr. 30/14717-18. However, he offers no proposal on how any anomalous passthroughs might be improved. In fact, witness Tye states that optimal rates for Standard A Regular were “outside the scope of my testimony” — in explaining his failure to examine unit cost contributions by Standard A Regular (in conjunction with this analysis of such contributions by ECR and First-Class).³⁴

Rates promoting the shifting of volume from Standard A ECR Basic to Regular 5-Digit Automation have been provided for in the proposed rates by witness Haldi, and in the Postal Service’s proposed rates by witness Moeller, without recourse to additional increases to the cost coverage of Standard A ECR. Volumes for ECR Basic letters dropped 22 percent from FY 1998 to FY 1999, demonstrating the effectiveness

³⁴ VP/CW-RT-1, pp. 24-25, Tr. 44/18871-72. Witness Tye stated, in the purpose for his testimony, that he had been asked to review the Postal Service’s rate proposals with regard to Standard A Regular. NAA-T-1, p. 1.

of the current rate setting methodology. Of course, management objectives should not receive greater weight than the proper application of the non-cost criteria in the identification of subclass cost coverages. VP/CW-RT-1, pp. 25-26, Tr. 44/18871-72.

2. Witness Tye Refused to Consider Unit Contributions Between Similar Subclasses.

Witness Tye proposes that ECR rates should at least maintain the unit contribution levels recommended in Docket No. R97-1, and that all undiscounted ECR rates should receive increases. He states that the unit contribution to institutional costs of the First-Class Mail letters subclasses is more than twice the corresponding contribution from ECR, and he criticizes the Postal Service for relying on cost coverages and markups rather than unit contributions to compare institutional contributions by subclass. Observing that, under the proposed rates, the ECR unit contribution to institutional costs would rise by 0.14 cents, while the First-Class unit contribution would increase by 1.32 cents, he claimed that comparison of unit contributions “facilitate comparisons among similar subclasses.” He also claims that worksharing distorts cost coverage percentages. *Id.*, pp. 3-4, 40-42, Tr. 30/14693-94, 14730-32.

Witness Tye is correct with regard to the value of comparing unit contributions between similar subclasses, but such analysis undercuts his proposals that the ECR cost coverage be increased. *Id.*, p. 19, Tr. 30/14709. He acknowledges that one consequence of his proposal to increase the ECR cost coverage would be to increase

further the difference in unit contribution between the higher ECR unit contribution and the smaller Regular unit contribution. Tr. 30/14889.

Standard A Regular and ECR are very similar in content and in value of service received; both require extensive mailer preparation, and have limited ECSI content. Moreover, the two Standard A commercial subclasses have far more in common than either subclass has with any First-Class Mail category. Yet the unit contribution of ECR is much higher, and has been growing since Docket No. R97-1. A comparison of Regular and ECR unit contributions thus supports a reduction in the ECR cost coverage.

This result explains witness Tye's contortions to avoid making a comparison between the unit contributions of these subclasses, as the purpose behind his testimony was to solicit a higher ECR cost coverage. However, by his own observation:

If the applicable avoided costs from worksharing are correctly calculated and if passthroughs are set to 100 percent, and all else is equal, then the unit contributions would be equal. [Tr. 30/14863.]³⁵

By this standard, the ECR cost coverage should be reduced.

3. Witness Haldi Demonstrates that Witness Tye's Proposals to Increase ECR's Cost Coverage to Facilitate Further Volume Shifts from ECR Basic Letters to 5-Digit Automation Letters Are Nonsensical.

Witness Haldi observes that Standard A ECR has a higher per-piece contribution to institutional costs, and a lower cost base than Standard A Regular. Thus, witness Tye's proposal, which seeks to discourage profitable mail through inflated rates in

³⁵ *Id.*, p. 20.

order to encourage volume growth on a less profitable product, makes no sense.

VP/CW-RT-1, p. 26, Tr. 44/18872.

Witness Tye's assertion that increases in ECR volume demonstrate diversion of advertising matter from private competitors has been shown to be contrary to the evidence. Witness Tye's sponsor, the Newspaper Association of America, reports that the volume of newspaper inserts grew from 56 billion in 1990 to 82 billion in 1997. Both figures are considerably greater than current ECR volume. *Id.*, p. 12, Tr. 44/18858.

D. Witness Haldi's Rebuttal Testimony Exposes Flaws in the Proposals of Both Witness Clifton and Witness Tye.

1. Witnesses Clifton and Tye Ignore the Institutional Contributions from Standard A ECR and Regular.

In their efforts to increase the institutional cost burden imposed on the two Standard A Commercial subclasses, witnesses Clifton and Tye ignore the significant contributions already being made. Witness Clifton acknowledges in his testimony that the contribution to the Postal Service's institutional cost by Standard A Commercial Mail exceeded volume variable costs by \$5,035 million and \$4,576 million in FY 1998 and FY 1999, respectively (Table 13). Tr. 26/12461. Without this contribution — or if the proposals by witnesses Clifton and Tye succeed in dramatically reducing this contribution (and Standard A ECR has one of the highest own price demand elasticities of any subclass) — the contributions currently drawn from Standard A would need to be recouped by other mail products. USPS-T-32, p. 6, Table 2.

2. Witnesses Clifton and Tye Ignore the Possibility That Standard A Mail Cross-Subsidizes Daily Delivery of First-Class Mail and Other Urgent Mail.

Witness Haldi demonstrates in his rebuttal testimony that a competitive alternate delivery system could be established in the United States, providing greater value of service to advertisers at lower prices than ECR rates.³⁶ He observes that such competition already exists in Sweden, and discusses an important article by Bernard Roy, an official of La Poste (the French Postal System) which explores in detail the establishment of such a system.³⁷ VP/CW-RT-1, p. 13, Tr. 44/18859.

Were such an alternate system to be successfully established within the United States, resulting in the diversion of significant volumes from Standard A Mail, the other classes of mail would see significant increases to their delivery costs, as the Postal Service's six days per week delivery standard would continue to force it to incur costs.³⁸ Likewise, fewer mailpieces would have to bear an ever-increasing burden of institutional costs. *Id.*, pp. 12-14, Tr. 44/18858-60. Witness Haldi presents financial data supporting the establishment of such a system:

³⁶ Witness Bradpiece (SMC-RT-1) testifies that he owns an alternate delivery system in Buffalo, NY, which provides delivery of his free community newspaper, including numerous inserts, one day a week at a cost significantly below rates charged by the Postal Service.

³⁷ "Technico-Economic Analysis of the Costs of Outside Work in Postal Delivery," in *Emerging Competition in Postal and Delivery Services*, ed. by Michael A. Crew and Paul R. Kleindorfer. Boston: Kluwer Academic Publishers, 1999.

³⁸ SMC witness Giuliano makes this point as well, from the context of Advo's experiences with postal rates. SMC-RT-2, p. 19, Tr. 44/19005.

in FY 1999, the Postal Service's total delivery costs (city and rural carriers combined) amounted to some \$16.5 billion. Of this amount, slightly over \$2.8 billion represented volume variable costs charged to Standard A Commercial Mail. In addition, Standard A Commercial Mail contributed \$4.6 billion to the Postal Service's institutional cost. [*Id.*, p. 15, Tr. 44/18861.]

One-sixth of \$16.5 billion amounts to some \$2.755 billion. Thus, the amount for one day per week universal delivery (reflecting Postal Service wages and benefits) is just slightly less than the volume variable cost charged to Standard A Commercial Mail for delivery. Witness Haldi concludes that the revenues from Standard A Commercial Mail are already more than sufficient to support a universal standalone alternate delivery system. *Id.*, pp. 15-17.

Mr. Roy observes that, if the stand-alone cost of the alternative delivery operator is less than the amount charged by the incumbent postal administration, then under such circumstances advertising mail can be seen as being in the position of cross-subsidizing some of the cost of daily delivery for urgent (*i.e.*, First-Class) mail. *Id.*, p. 14, Tr. 44/18860. Thus, the claims of cross-subsidization that have been a staple of efforts to increase Standard A Mail rates can be more credibly recognized as a logical basis for actually lowering such rates.

3. Inviting Competition From Alternate Delivery Can Be Counter-Productive.

Further, increases to the coverage and rates for Standard A ECR Mail only increase the potential profitability for would-be entrants to the hard-copy delivery business. Insofar as such competitors successfully divert advertising mail from the

postal system, these higher ECR rates will thereby (i) drive up rates for First-Class Mail, contrary to the result desired by witness Clifton, and (ii) reduce the rates for independent delivery of advertising mail, intensifying the competition for newspaper inserts, contrary to the result desired by witness Tye. *Id.*, p. 18, Tr. 44/18864.

E. The Postal Service's Requested Contingency Is Excessive.

1. The Contingency Must Be Recommended by the Commission, Not by the Postal Service.

The Postal Reorganization Act ("Act") specifically provides that the Postal Service's rates and fees "shall be reasonable and equitable," and that they shall be:

sufficient to enable the Postal Service under honest, efficient, and economical management to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service. For purposes of this section, "total estimated costs" shall include (without limitation) operating expenses, depreciation on capital facilities and equipment, debt service (including interest, amortization of debt discount and expense, and provision for sinking funds or other retirements of obligations to the extent that such provision exceeds applicable depreciation charges), and **a reasonable provision for contingencies.** [39 U.S.C. section 3621, emphasis added.]

In enacting this provision, Congress clearly had in mind that the Postal Service should not be expected to be bound by exactitude in its estimates of costs and revenues for the upcoming rate cycle. Thus, a contingency allowance should be included in estimated costs. On the other hand, Congress clearly intended, and stated, that any

such contingency allowance should be reasonable in amount. The reasonableness of the contingency is not separated out from all other ratemaking considerations and vested in the Board of Governors as witness Tayman and Strasser sometimes appear to believe.³⁹ The Commission has been entrusted with the responsibility of issuing an opinion and recommended decision identifying the rates that it has determined are justified by the record. There is no indication in the Postal Reorganization Act that the Commission was merely delegated to conduct hearings on the issue and then assume the role of a “potted plant,” passively deferring to Postal Service management.

2. The Postal Service Has Not Provided Adequate Justification for its Requested 2.5 Percent Contingency.

The Postal Service seeks a contingency allowance of 2.5 percent of total Test Year Cost Segment Costs (\$68,046,556,000), which amounts to \$1.68 billion. That proposed contingency reflects more than 46 percent of the total requested increase in Postal Service revenues. *See Direct Testimony of Postal Service witness Tayman, USPS-T- 9, p. 22, Table 15; Direct Testimony of Postal Service witness Mayes, USPS-T-32, Exh. USPS-32A, p. 1.* Numerous parties to this case oppose this extremely high, unjustified “cushion,” which not only would unnecessarily increase postal rates, it does not even appear to be in the best interests of the Postal Service.

The Postal Service has produced very little record evidence or reasoned analysis to justify the requested contingency allowance. It seems to believe that its near naked

³⁹ On cross-examination, witness Strasser admitted that “the Commission needs to determine the reasonableness of the contingency.” Tr. 46A/20222.

judgment — that a contingency allowance in a particular amount may be a good idea — is sufficient justification for adoption of the contingency, despite the obvious truth, that if the Postal Service's own revenue and cost projections are reasonably accurate, the contingency allowance (which serves to increase rates unnecessarily) will generate a high net profit, which should **not** be the Postal Service's goal.

The only witness offering to justify the contingency in the Postal Service's case-in-chief is witness Tayman, who offers very little information about precisely what factors had influenced the Postal Service to seek such a high contingency allowance. Witness Tayman spends approximately three pages on his purported justification and argument in favor of the requested contingency allowance, where he claims, on the basis of generalities, that an after-rates Test Year contingency request of \$1.68 billion was "judged as reasonable against unforeseen events and forecasting errors, given the magnitude of the Postal Service's operations and expenses." USPS-T-9, p. 43. Specifically, witness Tayman mentions the following "uncertainties": (i) recent financial performance had not been as favorable as in the mid-1990's, with revenue \$600 million below plan and significant cost cutting necessary to achieve the Service's net income plan; (ii) a "challenging" future outlook, and (iii) more expensive labor and health benefit costs. USPS-T-9, pp. 43-44.

None of the specific items alleged by witness Tayman could be classified as uncertainties. Indeed, aside from certain recent developments, they were all well known by the Postal Service at the time its rate request in this docket was filed, and presumably have been accounted for in the Service's cost and revenue projections.

Witness Tayman then tries to justify the Postal Service's attempted return to what he called "the historically normal contingency of 3.5 percent" on the theory that the Postal Service now operates in a more competitive environment than heretofore. Besides the higher rates incorporating the contingency would not be implemented until the second quarter of the test year. USPS-T-9, p. 44. Although including historical variance analyses with his testimony (*see* USPS Exhibit 9J), witness Tayman takes pains to disclaim the relevance of such analyses, which he says were included "for informational purposes only," stating that "it is not appropriate to use historical data to determine the size of the contingency in lieu of management's judgment about the future." USPS-T-9, p. 45. Aside from general statements about the value of management's judgment, this paragraph reflects the entire substance of witness Tayman's — and the Postal Service's — demonstration in the Request to support the \$1.68 billion contingency allowance that has been requested.

After viewing the significant opposition to its contingency proposal, the Postal Service apparently felt it was necessary to attempt to make a better defense of its contingency request. Witness Strasser (USPS-RT-1) expands upon, but essentially repeats, certain generalities contained in witness Tayman's testimony. Witness Strasser also attempts to rebut the testimony of several witnesses relative to the contingency issue, although he did not attempt to rebut the testimony of witness Haldi (VP/CW-T-1 p. 30-37, Tr. 32/15784-91).

Like witness Tayman, witness Strasser is limited to general assertions about the Postal Service's declining performance and the emergence of "new uncertainties." *See, e.g.*, USPS-RT-1, p. 4, ll. 6-10, and p. 6, ll. 1-4.

On cross-examination, witness Strasser claimed that he did not find witness Tayman's testimony relative to the contingency request to be deficient. *See* Tr. 46A/20327. Clearly, however, witness Strasser's rebuttal testimony was filed to rehabilitate the testimony of witness Tayman. For example, in the face of witness Tayman's strong denial of the value of historical variance analysis, as discussed above, witness Strasser admits that Postal Service management "does examine historical trends and performs objective and quantitative analyses" which "aid judgement in selecting the contingency." USPS-RT-1, p. 7. He then includes in his testimony a Postal Service response to an Office of the Consumer Advocate ("OCA") interrogatory, purporting to explain the Postal Service's framework for assessing the reasonableness of the contingency amount. *Id.* As the interrogatory response reveals (*see id.*), the purported framework is itself very general, and although it supposedly includes an effort to calculate certain values, no such valuation evidence was put forward by the Postal Service. Witness Strasser's testimony still presented no real evidence of reasonableness regarding the amount the Postal Service's requested contingency allowance on which the Commission could rely. Neither witness Tayman nor witness Strasser ever explains how Postal Service revenue and cost projections failed to take into account the specific uncertainties claimed to underlie the Postal Service's contingency request. This is a

serious defect in the Postal Service's case, and is one reason why its contingency request is undeniably too large.

3. The Evidence in this Docket Supports a Substantial Reduction in the Contingency.

Witnesses for several intervenors and the OCA demonstrate in different ways that the contingency allowance proposed by the Postal Service is excessive in the extreme.⁴⁰

"Contingency" connotes a specific back-up plan, and the contingency allowance is intended to operate as a cushion in the event that the Postal Service's revenues fall short of its costs. It is intended to be a specific, calculated estimate, and it must be grounded in reasonableness. It must not be based on the mere possibility that anything can happen. Mere speculation cannot be the foundation for such a budgetary estimate.

In this docket, as summarized above, the Postal Service's contingency estimate was both general and speculative. It is instructive to compare the Postal Service's general, seat-of-the-pants approach with the reasoned approaches of those parties who have critiqued the Postal Service's proposed contingency allowance.

⁴⁰ See Direct Testimony of John Haldi (VP/CW-T-1), Tr. 32/15784; Direct Testimony of Lawrence G. Buc (DMA-T-1), Tr. 22/9541 (p. 22); Supplemental Testimony of Lawrence G. Buc (DMA-ST-2), Tr. 38/17815 (p. 10); Direct Testimony of John C. Stapert (CRPA-T-1), pp. 5, 14-15, Tr. 30/14436, 14445-46; Direct Testimony of Win Zimmerman (PSA-T-1), pp. 7-9, Tr. 29/14129-31; Supplemental Testimony of Walter Bernheimer, II (DMA-ST-3), Tr. 46/20425 (p. 7); Supplemental Testimony of Stephen E. Siwek (AAP-ST-4), p. 12, Tr. 38/17100; Direct Testimony of Robert E. Burns (OCA-T-2), pp. 2-12, Tr. 22/19709-19; Direct Testimony of Edwin A. Rosenberg (OCA-T-3), pp. 2-29, Tr. 22/9806-33; Rebuttal Testimony of Edwin A. Rosenberg (OCA-RT-2), pp. 9-10, Tr. 41/18308-09.

a. Val-Pak Witness Haldi

Witness Haldi (VP/CW-T-1) submitted direct testimony for Val-Pak/Carol Wright analyzing the contingency, and explaining in various ways why and how it was excessive.⁴¹

(i). The Two-Pronged Contingency: Prospective Contingency and Retrospective RPYL.

The primary reason for not recommending the Postal Service's requested contingency allowance of 2.5 percent of total costs is that the Postal Service's request is inadequately supported and exorbitantly high. In addition, however, he explained why the prospective contingency should not be viewed alone, but in conjunction with Recovery of Prior Years' Losses ("RPYL").

The Postal Service relies heavily on the Postal Reorganization Act's statement that estimated costs should include a provision for a reasonable contingency. *See* 39 U.S.C. section 3621. As witness Haldi points out, the Commission's established practice of recommending an amount for RPYL must be incorporated into consideration of the contingency, because the "RPYL mechanism acts as a retrospective contingency mechanism, backstopping and taking over much of the function of the contingency fund." VP/CW-T-1, p. 33, Tr. 32/15787. As a retrospective contingency, it not only helps fulfil the Act's contingency requirement, but assures the Postal Service that its

⁴¹ As noted above, witness Strasser (USPS-RT-1) failed even to attempt to reply to the arguments advanced in the testimony of witness Haldi regarding the contingency in VP/CW-T-1.

actual revenue requirement will be met. In the words of witness Haldi, “[w]ith the RPYL mechanism firmly established, it is not necessary to be overly conservative about protecting against any shortfall during the Test Year via a large prospective contingency.” *Id.* If the prospective contingency were to prove inadequate, the Postal Service would be made whole by the retrospective contingency — RPYL.

(ii). Improved Accuracy of Postal Service Forecasts. Witness Haldi discusses how the improved accuracy of the Postal Service’s own cost-revenue forecasts virtually dispenses with any need for a contingency in this docket. Surely, if Postal Service forecasts accurately project a Test Year surplus equal to the amount of the Postal Service’s proposed contingency (less the amount budgeted for RPYL), a substantially lesser contingency amount should be more than sufficient. *See VP/CW-T-1*, p. 31, Tr. 32/15785.

(iii). High Contingency Can Lower Revenues and Accelerate the Need for the Postal Service to File a Rate Case. Witness Haldi explains that the contingency could have the effect of driving up postal rates faster than the rate of inflation, stimulating competition resulting in loss of market share, and thus possibly hastening, rather than deferring, the next rate increase. *VP/CW-T-1*, pp. 30-36, Tr. 32/15784-90.

(iv). A \$400-\$500 million Contingency Is Reasonable. Witness Haldi’s proposal for a **\$400-\$500 million** contingency is based upon a clear articulation of why a larger contingency is unnecessary, and is reasoned. It would eliminate the need for at least \$1.1 billion of the Postal Service’s proposed contingency allowance. *VP/CW-T-1*, p. 36, Tr. 32/15790. Furthermore, it is consistent with the testimony of the other

intervenor and OCA witnesses on this subject. Witness Haldi's recommendation is reasonable, and it merits the Commission's approval.

b. DMA Witness Buc.

DMA witness Buc submitted initial testimony supporting a contingency allowance of **1 percent** of total costs (\$668,978,000), reflecting a revenue requirement calculated to have been overstated by \$1.01 billion by the Postal Service. He points out that the Postal Service's estimated costs nonsensically assume an excessive rate of inflation and result in a revenue requirement inflated by at least \$1.3 billion. Tr. 22/9532. After setting forth a comprehensive analysis of the Commission's previous statements regarding the principles governing the determination of a reasonable contingency, witness Buc thoroughly critiques witness Tayman's testimony regarding the challenges and risks relied upon by the Postal Service. As witness Buc shows, "these challenges and risks do not support witness Tayman's request." *Id.*, p. 11, Tr. 22/9541. In witness Buc's opinion, "a reasoned and reasonable contingency is one percent in R2000-1." *Id.*, p. 17, Tr. 22/9547.

Following consideration of the Postal Service's supplemental evidence (*see* Supplemental Testimony of witness Patelunas, USPS-ST-44) in response to Commission Order No. 1294, witness Buc concludes that an even lower contingency in this docket was warranted, and redetermined a reasonable contingency allowance to be **0.25 percent** of total costs. *See* witness Buc Supplemental Testimony, DMA-ST-2, pp. 1-2, Tr. 38/17185-86.

c. PSA Witness Zimmerman

PSA witness Zimmerman addresses the Postal Service's financial successes in the 1990's. He points out that the last two rate increases (both as requested and approved) were less than the rate of inflation in the general economy. He questions why the Postal Service should estimate cost increases in excess of inflation. He further argues that if the USPS-proposed increase were reduced by the amount by which the Postal Service's estimated rate inflation exceeds the corresponding CPI-W inflation rate, the overall estimated increase could be reduced by \$1.5 billion. Accordingly, witness Zimmerman recommends that the contingency allowance requested by the Postal Service be reduced by at least \$1 billion. PSA-T-1, pp. 7-8, Tr. 29/14129-30.

d. OCA Witness Burns

Reflecting on established practices in other regulated industries, witness Burns points out the importance of tying a contingency reserve to possible future, uncontrollable events — which the Postal Service has not done in this case. He warns that anything less is “merely a device to even out controllable expenses.” OCA-T-2, p. 5, Tr. 22/17912. Addressing the absence of any articulated, substantial basis underlying the Postal Service's subjective management judgment regarding the requested contingency — the only “evidence” presented in the Request being generalizations from witness Tayman without any supporting information, data, or studies — witness Burns effectively rebuts the Postal Service's presentation of various “risk factors” as a justification for the excessive contingency request of \$1.68 billion,

and recommended that the contingency “be kept at one percent.” OCA-T-2, p. 12, Tr. 22/17919.

e. OCA Witness Rosenberg.

OCA witness Rosenberg concurs with witness Burns that the contingency should not be raised from its Docket No. R97-1 level of 1 percent of total estimated costs. Witness Rosenberg bases his opinion on “the application of a combination of sound public policy and regulatory principles,” as well as an evaluation of Postal Service witness Tayman’s testimony and exhibits, which provided no substantial evidence in support of the Postal Service’s request. OCA-T-3, pp. 3, 16-17, Tr. 22/9807, 9820-21. Witness Rosenberg lists numerous additional considerations militating in favor of a lower contingency, including the economy, the Postal Service’s recent financial success, the Postal Service’s own forecasts (and the Postal Service’s improved ability at forecasting), variance analysis and load probability analysis. OCA-T-3, pp. 7-19, Tr. 22/9811-23.

After warning of the dangers inherent in an excessive contingency allowance (*e.g.*, “moral hazard,” unnecessarily high rates and resulting “opportunity cost” to customers), witness Rosenberg compares the relative consequences resulting from a contingency allowance that was either too great or too small, and convincingly demonstrated that the contingency provision “should not be used to restore the equity account.” OCA-T-3, p. 26, Tr. 22/9830. In testimony directly complementing one of the primary points in witness Haldi’s testimony regarding the contingency, witness Rosenberg points out that the Postal Service has borrowing ability that would more than

adequately accommodate any situation involving a revenue shortfall. Furthermore, such a development should be preferable to one unnecessarily raising postal rates, jeopardizing the Postal Service vis-a-vis its competitors, and resulting in a back-door method of restoring equity to the Postal Service's account. OCA-T-3, pp. 26-28, Tr. 22/9830-32.⁴²

f. AAP Witness Siwek

Witness Siwek (AAP-ST-4) mostly confines his testimony relative to the contingency by observing the unreasonableness of the Postal Service's position in light of developments subsequent to the filing of this docket. Noting that the Postal Service's latest cost projections in this docket, made in response to Commission Order No. 1294, should have improved the Postal Service's forecast targets, which "have not changed even as the Postal Service has moved closer to them," AAP-ST-4, p. 9, Tr. 38/20427, witness Siwek testifies that "if the FY99 cost data is used, the contingency must be reduced." *Id.*, p. 10, Tr. 38/20428. Witness Siwek also suggests that witness Buc's initial recommendation of a 1 percent contingency provision based upon the various other factors not included in the testimony of witness Siwek "is worthy of serious consideration by the Commission." *Id.*, p. 11, Tr. 38/20429. His testimony

⁴² The Postal Service has denied that its managers and employees would personally benefit under the Service's Economic Value Added Program if the Postal Service's financial statements showed significant additional net income by means of a large contingency allowance. The Postal Service motivation in seeking an unnecessarily high contingency including restoration of equity, *see* cross-examination of Postal Service witness Strasser (USPS-RT-1), Tr. 46/20332-33, would not be in keeping with the proper purposes of the contingency.

regarding the contingency is consistent with that of every other intervenor addressing this issue, as well as with the testimony of the OCA witnesses. Clearly, according to the great weight of the evidence, the contingency allowance should be a fraction of what the Postal Service has requested.

Again, no one is arguing that the Postal Service's "cushion" be eliminated, but only that it be reduced to a reasonable amount, and viewed as consisting of its two component parts — the prospective contingency and the retrospective RPYL.

4. Application of the Evaluative Factors Articulated by the Commission in Prior Dockets Demonstrates the Inadequacy of the Postal Service's Contingency Request.

It is evident that the Postal Service has virtually ignored the significant factors which the Commission in previous cases has indicated should be considered in determining a reasonable contingency allowance. First, through witness Tayman, the Postal Service presents **variance analyses** but rejects those analyses as a foundation for its request. USPS-T-9, pp. 44-45. In so doing, it shrugs off a factor consistently emphasized by the Commission as significant in evaluating the reasonableness of a contingency allowance. *See, e.g., Op. & Rec. Dec.*, Docket No. R76-1, at 57; *Op. & Rec. Dec.*, Docket No. R77-1, at 22, 29, 33, 42; *Op. & Rec. Dec.*, Docket No. R87-1, paras. 2082-2084; *Op. & Rec. Dec.*, Docket No. R94-1, paras. 2102-2123.

Second, the Commission has also stressed the **financial condition of the Postal Service** as a significant factor in evaluating the reasonableness of a proposed contingency allowance. *See, e.g., Op. & Rec. Dec.*, Docket No. R80-1, at 21-22; *Op. & Rec. Dec.*, Docket No. R97-1, paras. 2001-2003. While the Postal Service has

been forced to admit the success of its recent financial performance, as well as its healthy financial condition, it tries to avoid the significance of these facts by claiming generally that recent performance “has not been as favorable as in the mid 1990's” and that the Postal Service has fallen short of its revenue plan, which caused significant cost cutting to achieve its net income plan. USPS-T-9, p. 43. But that does not constitute an unhealthy financial condition, and provides no support for a \$1.68 billion contingency request.

Third, the Postal Service has not been able to garner support from any evidence regarding the **state of the economy**, still another significant factor to be considered in evaluating the reasonableness of a contingency allowance. *See, e.g., Op. & Rec. Dec.*, Docket No. R76-1, at 56-57; *Op. & Rec. Dec.*, Docket No. R80-1, at 21-22⁴³. Both witness Tayman (USPS-T-9) and witness Strasser (USPS-RT-1) stressed risk as

⁴³ Postal Service witness Tayman does not appear to have addressed this factor at all. Postal Service witness Strasser argued, in an attempt to rebut the testimony of witness Buc (DMA-T-1), that the state of the economy supports a higher contingency because of increasing inflation as well as low unemployment. USPS-RT-1, pp. 9-10. Witness Strasser cannot reasonably rely on both of those offsetting items to support an argument that the state of the economy justifies a high contingency allowance. *See* Tr. 46A/20362-63. In testimony typifying the Postal Service’s approach to the contingency allowance — *i.e.* the Postal Service, and not the Commission, should decide what the important factors are — witness Strasser attempted to disregard the state of the economy issue by claiming, “a strong economy does not necessarily translate into a lower contingency provision.” USPS-RT-1, p. 10, Tr. 46A/20190. This is reminiscent of witness Tayman’s statement of belief that “historical variance analyses should not be the basis for determining the need for a contingency or its size.” USPS-T-9, p. 45. Obviously, the Commission does not rely upon either of these factors exclusively in evaluating the reasonableness of a contingency allowance. Nevertheless, they are both important factors that bear on the question of reasonableness, as the Commission has consistently held from rate case to rate case over the years.

perceived by Postal Service management as a significant factor in evaluating the reasonableness of the contingency allowance. The difficulty with that factor, of course, is its complete subjectivity. This is particularly so where the Postal Service witnesses neither articulate details regarding the basis for such perceived risks, nor attempt to arrive at a relevant financial range for each such purported unknown. Thus, the Postal Service has failed to demonstrate that its requested contingency is reasonably related to future uncontrollable events. It is not enough to argue, as the Postal Service has done, that virtually anything can happen. That argument could just as well support a contingency allowance of one dollar. As OCA witness Burns points out, reasonable contingency reserves should be based upon the likelihood that the expense and revenue forecasts contain misestimates. However, the Postal Service's evidence does not even approach such a showing. OCA-T-2, pp. 3-12, Tr. 22/9710-19. Witness Rosenberg's testimony also points this out, and provides independent evidence of the lack of any need for a contingency allowance in excess of 1 percent. OCA-T-3, pp. 7-29, Tr. 22/9811-33.

In addition to all of the factors mentioned above, certain of the witnesses, including witness Haldi, stress the need to focus on the probably negative results of a too-high contingency. Pointing out that almost half the proposed rate increase, "an astonishing 46 percent, is being driven by the prospective contingency factor," the Postal Service's requested contingency allowance is "counter-productive to sound management of the Postal Service," in that it appears to provide the Postal Service with

a cash cushion which will enable the Service to defer the next rate case, VP/CW-T-1, p. 35, Tr. 32/15789, but:

in reality, it does just the opposite. By driving up postal rates across the board faster than the rate of inflation, it stimulates the kind of competition that is based on innovations both in information technology and in more traditional arts. With the current extremely rapid pace of technological and institutional changes in the private sector, the initial revenue increases provided by higher postal rates can easily turn into painful market losses even before the next rate case. Thus, a higher contingency allowance leads to a counter-intuitive result. Instead of providing a cushion that would delay the need for the next rate case, it can actually hasten the day when yet another rate increase, also above the rate of inflation, will be needed. [VP/CW-T-1, p. 36, Tr. 32/15790.]

The Postal Reorganization Act was intended to help transform the Postal Service into a self-sufficient organization, estimating its own projected costs and seeking sufficient rates to provide the revenue to meet those costs. Since there is a statutorily-mandated break-even goal, a contingency allowance provision obviously was desirable, and the Act included a reasonable contingency as an element of estimated costs. The contingency serves two basic purposes. The first is to provide insurance against the possibility of a test year deficit resulting from underestimates of test year accrued revenues and expenses. The second is to protect against the possibility of a test year deficit resulting from unforeseeable events not capable of being prevented through honest, efficient, and economical management. *See Op. & Rec. Dec.*, Docket No. R84-1, para. 1017. In this docket, as summarized above, there is substantial evidence that the Postal Service's need for a contingency allowance is not great, based upon all

of the factors traditionally considered by the Commission, and the Postal Service has provided no substantial evidence to the contrary. Clearly, based upon the record, a reasonable contingency allowance in this docket would be the \$500 million recommended by witness Haldi. In no event should it exceed 1 percent of total costs (which, rounded, would amount to \$700 million).

CONCLUSION

Val-Pak/Carol Wright submit that the record and testimony filed herein by witness Haldi support their rate and classification proposals, and that the Postal Service's request with respect to Standard A ECR mail should be modified as set forth in witness Haldi's direct testimony.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "William J. Olson", written over a horizontal line.

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APPENDIX A

Computations Using Selected Regressions from USPS-LR-I-92

Appendix A consists of two tables, A-1 and A-2. These tables provide the original data from Library Reference USPS-LR-I-92 to support Tables 1 and 2 in the text, *supra*.

Columns 2 and 3 show the intercept value and slope for each respective equation shown in USPS-LR-I-92 on the pages indicated in column 1.

Table A-1

Underlying Regressions and Indicated Rate for a 16-Ounce Piece of
Standard A Regular Mail, Using Witness Daniel's Regressions
of the form $y = a + bx$

where

y = cost
a = intercept
b = slope
x = weight (in ounces)

Description	(1) Source: LR-I-92, Section 1	(2) Intercept Value (a)	(3) Slope (b)	(4) 16b	(5) Cost of a 16-ounce Piece: $a + 16b$	(6) Cost of a 16-ounce Piece $x \times 1.329$
Detailed Half-Ounce Increments:						
1. All shapes	P. 10	0.0312	0.0481	0.7696	0.8008	1.0643
2. All shapes, pound-rated	P. 11	0.1330	0.0628	1.0048	1.1378	1.5121
3. Flats	P. 16	0.2618	0.0059	0.0944	0.3562	0.4734
Combined Weight Increments:						
4. All shapes	P. 12	0.0588	0.0412	0.6592	0.7180	0.9542
5. All shapes, pound-rated	P. 12	0.0594	0.0524	0.8384	0.8978	1.1932
6. All Flats	P. 18	0.2465	0.0059	0.0944	0.3409	0.4531
7. All Flats pound-rated	P. 18	0.0670	0.0233	0.3728	0.4398	0.5845

Table A-2

Underlying Regressions and Indicated Rate for a 16-Ounce Piece of
Standard A ECR Mail, Using Witness Daniel's Regressions
of the form $y = a + bx$

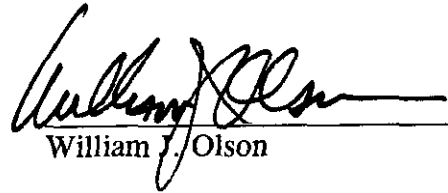
where

y = cost
 a = intercept
 b = slope
 x = weight (in ounces)

Description	(1) Source: LR-I-92, Section 2	(2) Intercept Value (a)	(3) Slope (b)	(4) 16b	(5) Cost of a 16-ounce Piece: $a + 16b$	(6) Cost of a 16-ounce Piece $x \times 2.088$
Detailed Half-Ounce Increments:						
1. All shapes	P. 10	0.0126	0.0192	0.3072	0.3198	0.6677
2. All shapes, pound-rated	P. 11	0.0495	0.0247	0.3952	0.4447	0.9285
3. Flats	P. 17	0.0265	0.0155	0.2480	0.2745	0.5732
Combined Weight Increments:						
4. All shapes	P. 12	0.0257	0.0161	0.2576	0.2833	0.5915
5. All shapes, pound-rated	P. 12	0.0312	0.0214	0.3424	0.3736	0.7801
6. All shapes, pound-rated	P. 13	0.0048	0.0176	0.2816	0.2864	0.5980
7. All Flats	P. 19	0.0325	0.0137	0.2192	0.2517	0.5255
8. All Flats pound-rated	P. 19	0.0113	0.0178	0.2848	0.2961	0.6183

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.



William J. Olson

September 13, 2000